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# Regulation

Sept/Oct 1980 AEI Journal on Government and Society

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## Compensating Victims of Policy Change

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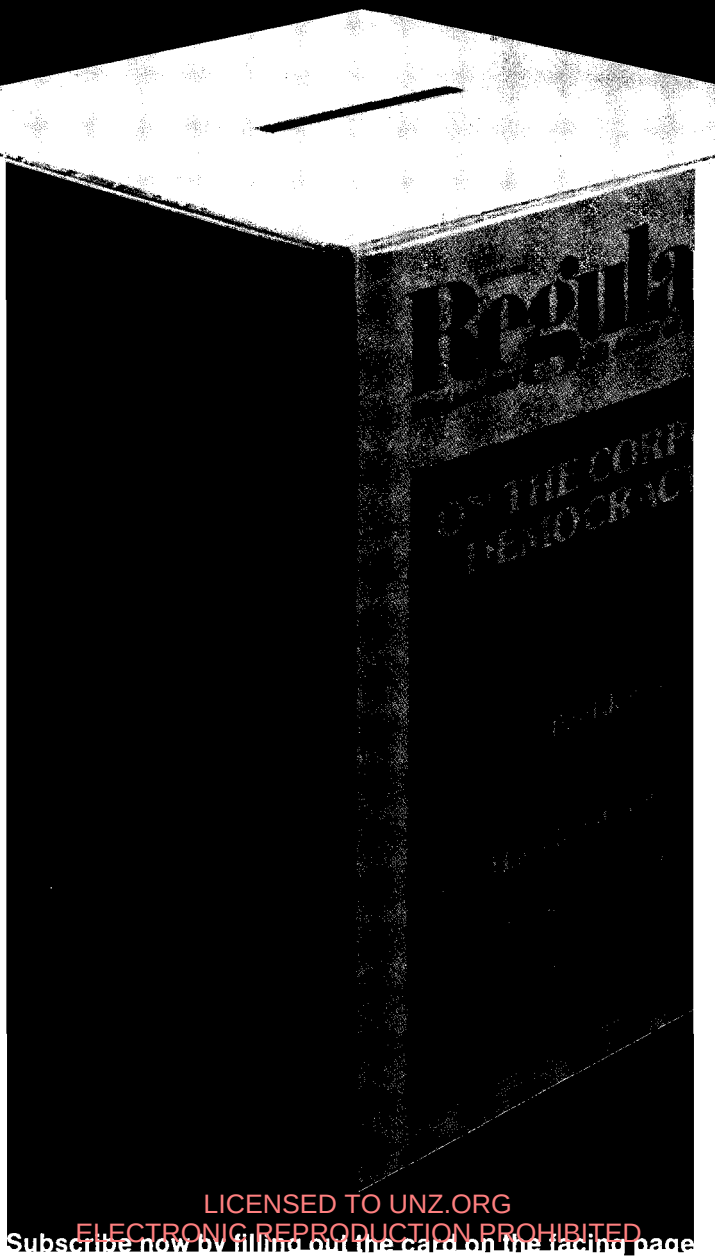


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# Regulation

Sept/Oct 1980 AEI Journal on Government and Society


*Competition of ideas is fundamental to a free society*


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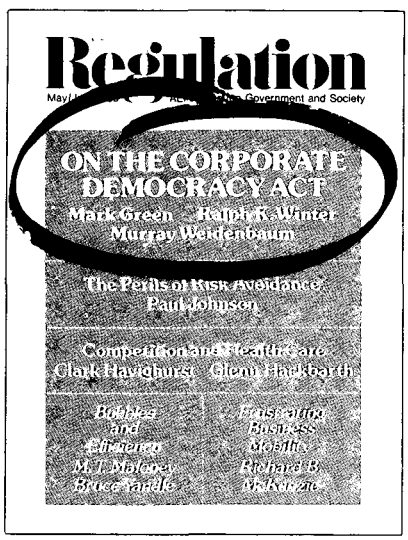
# Letters

*We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.*




## Corporate Democracy

[*The May/June issue of* Regulation *carried three articles on the proposed Corporate Democracy Act—Mark Green's "The Case for Corporate Democracy," Ralph K. Winter's "What's* Not *in a Name," and Murray L. Weidenbaum's "What Is True Corporate Responsibility?" The following letters are responses to these articles.*]

TO THE EDITOR:

If we ever rid ourselves of the government-imposed shackles that have left us with the lowest productivity rates, savings rates, and investment rates of the industrialized world, it will be because we have managed to avoid the kind of thing represented by H.R. 7010, the proposed Corporate Democracy Act. Mark Green's defense of the proposal is naive at best ("The Case for Corporate Democracy").

Green argues that federal control is necessary to make corporations accountable. Accountable to whom, I ask? Take the Chrysler case. The consumers "fired" Chrysler because it was not doing what they wanted. What did the federal government do? In effect, through the bailout, government told Chrysler that it was accountable not to the masses but only to government. Ironically, people like Green and those in the labor movement who *profess* consumer concern were the ones who weighed heavily in making Chrysler accountable to government. If this is the kind of protection that we can expect from H.R. 7010, throw me to the bear.

Green also talks about the evils of price fixing by corporations. But I ask him, is price fixing less evil when done by government, often at the request of various interest groups? For example, the Interstate Commerce Commission long required that truckers get together and fix *minimum* price. The Agriculture Department requires milk producers to sell their milk products at fixed *minimum* prices. The Labor Department, through the Davis-Bacon Act, fixes *minimum* prices for labor on federally funded construction projects. And, of course, there is the minimum wage law which sets the *minimum* price for labor. In each of these cases, if the seller *lowered* his price, he would be carted off to jail or lose his right to do business. How are consumers benefited by this kind of price fixing?

I agree with Green that price fixing is an anticompetitive, collusive activity. But virtually all of the price fixing and other kinds of collusive activity done by businesses and union is done with the active support of federal, state, and local governments. In this respect, business is just like labor: it uses the coercive powers of government to collude against competition. It would seem that Green's proper target is the federal government itself.

Finally, Green's discussion of H.R. 7010's provision for prenotification by firms of plans to relocate and for evaluation of those plans by the Labor Department reflects a general lack of awareness that it is possible to kill the goose that lays the golden egg. For years labor unions have been heaping abuse on business in the form of high wage and benefit claims. Cities have done their share in the form of high business taxes and wage taxes. Now many firms are choosing to leave these climates for more fertile grounds (often in other countries). Green and others would like to eliminate this option and make the firms captive to a particular location. I say this fully cognizant of Green's comment that "the proposal is not to require government approval for a move but. . . ." Of course, we were assured, years ago, that the Civil Rights Act would not require racial quotas to be used in employment. I am certain that down the road, if H.R. 7010 were passed, some Supreme Court Justice similarly would not be governed by the words of the act, but by its "legislative intent."

As for Professor Winter's analysis of the Corporate Democracy Act, I found it crisp and sharp. That H.R. 7010 did not cover the broadcast media should not have been as puzzling as it was to him, however. A legal scholar should understand that the same Supreme Court that avoids substantive interpretation of the Fifth Amendment does not quail from substantive interpretations of the First Amendment. A court challenge by the broadcast media would almost certainly lead to a finding that the Corporate Democracy Act is unconstitutional. The backers of H.R. 7010 are not unintelligent people.

*Walter E. Williams,*
*Visiting Professor,*
*George Mason University*

TO THE EDITOR:

The general goal of the Corporate Democracy Act must be achieved, if political democracy is to be established in this country. Huge conglomerates dominate our lives today, and manage, through the use of delaying tactics, to reduce the effectiveness of the worker-consumer protection efforts of OSHA, FTC, CPSC, and FDA. To the extent that the Corporate Democracy Act focuses attention on such corporate



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abuses, it serves a purpose. Its corporate disclosure provisions will indicate where further corrective action is needed; I would also like to see full disclosure of consumer injury and fraud claims and settlements. Local communities have a right to reasonable notice before plants are closed, so that appropriate adjustments can be made; employee groups should also be helped to purchase and operate such plants, where this is a reasonable option. Businesses should not be free to fire employees for political opinion or for reporting corporate action dangerous to consumers or workers. And certainly corporate executives should be held responsible for knowing acquiescence in decisions injuring workers, consumers, or the community at large.

But I doubt that H.R. 7010 would improve shareholder control over corporate policies or boost participation in the election of directors. Corporate shareholders, too widely dispersed and too busy to participate in a meaningful way, will continue to be sitting ducks for well-heeled proxy campaigns. But there is an answer, as illustrated by agricultural cooperatives, owned either by farmers directly or by local cooperatives that are in turn owned by farmers. Some of these cooperatives are even to be found in the ranks of the "Fortune 500." Here, being a "shareholder" means considerably more than it does with Exxon or General Motors, because ownership is tied to use of the corporation's services. Further, in most such cooperatives, each shareholder has only one vote and proxies are prohibited—wisely, in my opinion.

To implement this "user-ownership," most larger cooperatives employ some form of "representative democracy," with regional election of delegates. The better cooperatives also have year-round member education programs to help farmers understand the business they own and use. Finally, these larger cooperatives complete the cycle of user-ownership by returning most of their earnings to those who use their services—not to absentee owners. These "patronage refunds" or "savings returns" are paid out in cash and (sometimes) partly in credits to individual share investment accounts, thus helping provide capital without having to offer unearned profits to absentee owners.

But there is something missing in all this: none of these "Fortune 500" cooperatives are consumer-owned, and so they are related to *consumers* in much the same way as any other corporation. And that points up the most significant ingredient missing from our economy today: ownership and control of corporations by those whose needs —as Adam Smith and scores of others tell us—the economic system is supposed to serve.

Certainly most U.S. business will never be consumer-owned. Indeed, even in Sweden, only about 20 percent of the nation's retail business is handled by consumer-owned cooperatives. But once a significant consumer-owned sector is developed, we can expect it to have major influence in setting standards and determining policies. And, as it becomes stronger, its example will reduce the effectiveness of big business anti-consumer lobbies.

What will it take to build such a consumer-owned sector? Certainly the new National Consumer Cooperative Bank, given ten or fifteen years of experience and growth, will be important. In most states, we also need better enabling legislation, requiring democratic consumer control structures, one vote per member with limited dividends on shares, a prohibition on proxies, and development of representative assemblies. There is also a need for improved member education and management development, as well as the establishment of a consumer cooperative development corporation.

Given all this—and it will require nothing less—we can develop in this country a responsible corporate democracy far beyond what is likely to result from enactment of the Corporate Democracy Act.

*Art Danforth,*
*Consultant,*
*Consumer Cooperative*
*Development and Organization*

TO THE EDITOR:

American business should be seeking two things today: competence in corporate leadership and capital. But the Corporate Democracy Act would not bring us closer to either goal.

For instance, even a generous interpretation of the act's criteria for selecting new directors gives no assurance that the persons selected would have a capacity for directing enterprises greater than that of today's directors; in fact, there is a powerful presumption against it.

The likelihood of reduction in the average competence of the directors, along with the new requirements and the "anti-business" spirit of the act, would add to the risks of investment. Such a rise in risk would make it harder for large corporations to get new capital.

The concept of democracy is properly applied in a realm quite different from that of the business corporation, because production, conceived broadly to include efficiency now and innovative progress over the years, is different in essence from government, the agency for coercion.

The U. S. business system has served us very well indeed; living standards have risen substantially. Has the political system performed equally well? I think not, and all proposals to enlarge the role of politics in business should be considered in light of this contrast in performance.

*C. Lowell Harriss,*
*Columbia University*

TO THE EDITOR:

I shall limit my response to Murray Weidenbaum's article—"What Is True Corporate Responsibility?"—and further target my remarks to one critical sentence in that article. He writes: "Let me repeat the thesis of this article. . . . As an economic unit, if the business firm has any fundamental obligation to the society of which it is a part—aside from or even in contrast to its commitments to its shareholders—it is to produce those goods and services that consumers desire in order to enhance their welfare as they see it." This calls for two comments.

The first concerns the word *obligation.* An obligation is a moral undertaking—a commitment entered into for reasons other than those of self-interest. When we speak of the obligation of business firms we speak of undertakings other than those that self-interest alone suffices to bring about. An "obligation" to satisfy the needs of consumers is like an obligation to do oneself a favor. It robs the idea of corporate responsibility of all substance. What that substance should be is another question, but surely it is not to follow the calculus of profit. That may be expedient, useful, rational, or many other things, but an "obligation" it is not.

Second, there is the matter of the welfare of consumers as they see it. That would be unexceptionable enough did not business spend billions to persuade consumers to define their welfare in ways that are

*(Continues on page 55)*



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# Perspectives
## on current developments

### Enterprise Zones: The New Fluoride for Urban Decay

When politicians and experts of all persuasions look at the country's urban centers, they see the same grim facts. Cities have been losing industry and population, and the people who leave tend to be more skilled and affluent than those who remain. The result is high unemployment, a shrinking tax base, and a growing demand for social services.

Government's various programs for addressing the problem—job training, public employment, tax credits for hiring disadvantaged workers, urban renewal, and so on—have met with little success. A relatively new proposal, attributed to Sir Geoffrey Howe (now Britain's chancellor of the exchequer), takes a different approach. It seeks to revitalize the inner city by offering significant tax and regulatory relief to businesses that originate in, or move to, urban areas having high unemployment or widespread poverty. A trimmed down version of that proposal—the Urban Jobs and Enterprise Zone Act (H.R. 7240)—was introduced in the House on May 1, 1980, by Representative Jack Kemp (Republican, New York). It would offer tax incentives but not regulatory relief to qualifying businesses located in urban "enterprise zones."

In order to be designated an "enterprise zone" by the secretary of commerce, an area must have a population of 4,000 or more (except for Indian reservations), and must satisfy one of the following conditions: (1) an unemployment rate for the recent twenty-four months of at least twice the national average and 30 percent of the area's families living below the poverty level, (2) an unemployment rate for that period of at least three times the national average, or (3) at least 50 percent of resident families living below the poverty level. It must also agree to make a permanent reduction in property tax rates of at least 20 percent within four years. Enterprise zone status would last for a minimum of ten years but could be revoked if the locality failed to follow through on the property tax reduction.

For a business in an enterprise zone to qualify for the special tax incentives, at least 50 percent of its workers must do substantially all their work in the zone and 50 percent of such "qualified employees" (that is, 25 percent of the firm's work force) must reside in the zone.

The Kemp bill's list of incentives would produce major tax relief—estimated by the bill's proponents at approximately $1.4 billion—for firms that met the eligibility criteria:

- Tax rate reductions would provide the bulk of the relief. The social security tax rate for qualified employees and employers would be cut in half for adult workers and by 90 percent for those under twenty-one years old (estimated tax relief—$1.1 billion). Also, the tax rate that corporations pay on capital gains would be cut from 28 percent to 15 percent for three types of property: (1) office and factory equipment used primarily in the active conduct of a business located in the enterprise zone; (2) land and structures located in the zone and used in the conduct of a business or sold or exchanged by an individual whose principal residence is in the zone; and (3) a financial interest in a corporation, partnership, or other entity that was a "qualified business" in the most recent taxable year (estimated relief—$75 million). Finally, the corporate tax rate schedule, which now ranges from 17 percent on income below $25,000 to 46 percent on income over $100,000, would be lowered to a range for those income levels of 14 to 39 percent (estimated relief—$131 million).
- In addition, the bill would authorize certain accounting changes for qualified business, in order to reduce the complexity and cost of business accounting and to strengthen the financial position of new firms during their early years. A simplified form of accelerated



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depreciation—three-year, straight-line—would be available for any property put in service in a zone, up to a maximum value of $500,000 (estimated relief— $53 million). Qualified businesses would also be allowed to carry net operating losses forward for ten years instead of only five, and businesses whose gross annual receipts have never exceeded $1.5 million would be given the option of using the cash basis for computing income (without any requirement to take inventories into account).

• The bill also provides that the Foreign Trade Zone Board should expedite applications from enterprise zones for "foreign trade zone" status, taking into account both their current and future economic development. Duty is not owed on goods that enter a foreign trade zone until they leave the zone, or on goods that are re-exported before leaving the zone. But, perhaps the greatest job stimulus from foreign trade zone status is the fact that no duty is owed on the value added to goods reprocessed within a zone, a provision that gives import companies a strong incentive to build job-creating assembly and reprocessing plants there.

At a theoretical level, the enterprise zones proposal must be viewed against the long-standing controversy over whether it is more efficient for the government to expand employment opportunities by moving people to jobs or jobs to people. Most government efforts to date have followed the former approach—giving people education, job training, or transportation to help them move up job ladders or across boundaries into long-term employment. The enterprise zones plan follows the other course, enticing existing or incipient enterprises to locate in areas of high unemployment.

Critics of the plan are skeptical that business tax breaks can reverse what appears to be an inexorable trend of jobs toward suburban, exurban, and rural settings. The flight of jobs and skilled workers from urban core areas, they claim, is a complex long-range trend, resulting from a confluence of factors including the changing composition of national output, improved transportation and communication facilities, the attractiveness of the lower wages or nonunionized labor available outside the cities, and the general unattractiveness of business conditions in the inner city. Proponents of H.R. 7240 seek to stimulate *new* business inside the zones rather than reverse past job flight and hope to make the tax relief substantial enough to do the job.

One must question the assumption that most of the businesses locating in the zones would be new ventures. To the extent that relocations became the main vehicle for job creation within the zones, the increased job opportunities thereby created inside the zones would have to be offset against the reduced job opportunities that would occur in the (often adjacent) areas from which the businesses had moved. In other words, to some extent, the scheme would simply shift unemployment across rather artificial borders. Indeed, there would be opportunities for a considerable amount of "gaming" as small businesses—whose low overhead made a move easy, or which were ready to relocate anyway—picked up and moved perhaps only a few blocks into the most convenient enterprise zone. In such cases the tax incentives, "financed" by the general taxpayer, will have done little to help the unemployment problem nationwide.

Furthermore, while it is true that small firms create more new jobs than large firms, they also fail more often. If it is primarily small firms that would utilize these tax advantages, their attrition rate must be taken into account in predicting the ultimate job impact of the enterprise zone package.

Perhaps the most questionable promise held forth by the proposal—implicit, if not expressed—is substantial reduction of minority unemployment. Renewed prosperity for the nation's cities tends to be equated with higher income for the cities' current inhabitants. The scheme might have that result. However, if in fact the new businesses simply brought with them new employees (or, more likely, old employees relocated from the suburbs), it would be the cities, not their present inhabitants, that would have been "saved." This might itself be a desirable goal, but it must not be confused with the goal of minority employment. Some movement of professional and skilled white workers back into the cities has already been noted in some sections of the country—aided, in cities such as Chicago and Washington, by mortgage loan subsidies and "homestead" laws that are viewed by some minority groups as efforts to squeeze them out of desirable inner-city locations. The enterprise zone proposal might be no more than another step in this di-



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rection, moving the human component of the inner city to the near suburbs.

The central conservative appeal of the legislation is also subject to question—that is, the notion that it is not a program to pile inner-city residents into dead-end public jobs, but rather will "harness the energy" of the private sector. It can be argued, to the contrary, that at least those private jobs which would not exist without public subsidy are, in a real sense, public jobs. Subsidization of inefficient private businesses is simply the latest form of pork barrel—and perhaps the most dangerous, since, as in the case of Lockheed and Chrysler, it does not provoke unified opposition from those quarters generally opposed to government intervention. Perhaps the principal way in which employment by subsidized private firms differs from outright welfare is that the money probably goes to the less needy. Unless, of course, hiring conditions are imposed—an adjustment that would be likely to occur in the case of the enterprise zone proposal.

The proposal might have some merit as a demonstration project, especially if it included the easing of those regulatory and economic constraints on the free market whose substantial distorting effect is not generally appreciated—for example, environmental controls and the minimum wage. Such regulatory "easements" are part of the proposal being studied in Great Britain, but they were eliminated from the Kemp bill in order to make it less controversial and to keep it within the jurisdiction of a single House committee. Because of that compromise, the bill in its present form can demonstrate little more than the acknowledged truth that financially subsidized enterprises are more prosperous.

At base, H.R. 7240 is a familiar example of regulatory fine tuning—the use of new governmental incentives or constraints to offset the undesirable effects of governmental incentives or constraints already in place. Some of the policies responsible for the decline of the cities are not obscure or difficult to identify: mandatory busing, subsidization of mass transit and (through the highway program and gasoline price controls) even private automotive transit from the suburbs, and a tax structure and educational funding system that permits persons of moderate income to purchase quality education only through the purchase of real estate (that is, suburban housing that is higher priced largely because it comes with better public schools). The attempt to offset these influential policies with yet another regulatory program may be a new wrinkle—but in a very old and rumpled piece of cloth.

## Academic Freedom Misapplied

Professor James Dinnan of the University of Georgia's College of Education is not a typical prison inmate. But then his offense is not typical either. Professor Dinnan began on the road to crime when he set as a member of a faculty peer-review committee that voted, six-to-three, against granting tenure to Assistant Professor Maija Blaubergs. Blaubergs sued the university, charging that she had been denied the right of free speech and free association and had been discriminated against because of her sex and national origin. When her lawyer demanded that six members of the committee disclose how they had voted, all but Dinnan cooperated. Dinnan based his refusal on the argument that, in accordance with university guidelines, the vote had been taken by secret ballot, and that secrecy in such decisions is necessary to protect faculty members against outside pressure.

Federal Judge Wilbur Owens ruled that Dinnan's refusal constituted contempt of court, and sentenced him to ninety days in prison and a $3,000 fine. The U.S. Court of Appeals for the Fifth Circuit denied his appeal—noting that the professor had "the keys to prison in his own pocket." Dinnan left his detention quarters at Elgin Air Force Base on October 3, reportedly ready to risk another longer sentence by remaining mute at his hearing in November.

Dinnan's case has received wide, and generally sympathetic, national press coverage as representing courageous defense of academic freedom. The courage is unquestionable, but the cause in which it is enlisted seems misdescribed and probably misperceived. There are some governmental impositions that are directed explicitly at freedom of intellectual inquiry, such as laws prohibiting the teaching of evolution (or, for that matter, the teaching of nonevolution). These may in every sense be said to be directed against academic freedom. It is something else, however, to describe in



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that fashion laws of more general applicability (such as laws against fraud, or libel, or, to come to the point, employment discrimination) and the subsidiary imposition deemed necessary to enforce those laws (such as reporting and disclosure requirements). Such laws and impositions may be said to infringe academic freedom, in any meaningful sense, only if they are directed against some act or practice that is particularly necessary for academic inquiry. Otherwise, the cry of academic freedom amounts to no more than a claim for special exemption from measures that bear no less heavily upon the rest of society.

The object of Dinnan's protest seems to fall within the latter category, which makes the outpouring of editorial support difficult to understand. One cannot imagine equivalent sympathy for a lawyer, let us say, who declines in the course of an employment discrimination lawsuit to disclose the details of rejection of a female candidate for partnership; or for a doctor with respect to a female candidate for hospital residency; or for a corporate director with respect to a female candidate for an executive position. Yet the need of academics to make fearless and uncoerced decisions with respect to their colleagues is surely no greater than that of other professionals; nor are job and promotion qualifications in the academic fields any more ineffable and difficult to verify.

Thus, Dinnan is either defending a more general principle of academic association, or he is asking for special and functionally unjustified privileges for his own profession. Of course, the latter criticism can be met head-on, by simply asserting that universities are the most important of institutions and thus deserving of preferential treatment. Such a judgment would probably not be shared by that portion of the population (the majority) that does not belong to what might be called the intellectual class, and whose own social worth is not thereby aggrandized. And even intellectuals must admit that universities are hardly more necessary than the institution of government itself—which has been subjected to employment and promotion inquiries at least as rigorous. Nor is it persuasive to argue that university preferences are justified because there is a unique threat that government will seek to control educational institutions. That is again, for the intellectual class, a self-flattering assessment: the tyrant would probably place GM, AT&T, and CBS well above Harvard on his target list. It is, moreover, a curious argument in a society that has increasingly committed all of its education, from kindergarten through graduate school, to institutions owned and operated by the government, while generally refraining from government ownership of commercial enterprises.

Indeed, an argument can be made that if there is any institution which should not be exempt from governmental impositions generally made upon other private associations, it is academe—for in modern times, at least, that is the institution in which many of those impositions are first conceived and formulated. Nothing will so ensure care and concern in that process as the requirement that the conceivers and formulators drink from the same cup they have prepared for the rest of us.

In short, Dinnan's case seems too difficult to be resolved by a facile reference to academic freedom. Disclosure requirements associated with equal employment opportunity laws are not uniquely directed against academic thought; and there is no special reason for academic exemption. The real issue is the extent, if any, to which governmental pursuit of the desirable goals of these laws should be restrained (and thereby rendered less effective) by a concern for the confidentiality that is an important element of freedom of association, and therefore an important value for all free institutions. One suspects that the apparent consensus of editorial opinion that emerged in the Dinnan case on the assumption that only Mr. Chips was involved will rapidly dissolve when the issue is seen to include Howard Hughes as well.

## Energy Independence Down the Tube?

Large-scale conversion to coal could probably reduce the free world's dependence on oil to the point where supply disruptions or OPEC price increases could not threaten serious consequences. For this reason, the free world leaders resolved at their June meeting in Venice to draw upon the huge coal reserves of the United States. A month earlier the *World Coal Study*



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(drafted by experts from sixteen countries under the direction of MIT's Carroll L. Wilson) found that a tripling of U.S. coal production to 2.1 billion tons by the year 2000 is needed to prevent the radical restructuring of free world economies. The same study also provided the good news—that even allowing for the costs of the strict mining and air pollution controls that most Western countries have imposed, the recent rise in world oil prices has made extensive coal use and export economically feasible.

But returning to coal as a primary energy source will not be easy. While the regulatory constraints facing the industry may prove manageable, there remains another major obstacle —concern that U.S. transportation and port facilities cannot handle a large increase in traffic at reasonable rates. Potential coal users, electric utilities in particular, argue that high and rising rail rates—already allowed by the Interstate Commerce Commission under the 4-R Act of 1976 and now more readily available under the railroad deregulation enacted in October—impede their ability to convert to coal.

All of these concerns are focusing attention on the coal slurry pipeline, a competitive and, according to its supporters, highly efficient system for the transport of coal. The railroads, bitterly opposed, have blocked coal pipeline rights-of-way (1) by refusing to grant easements for the laying of pipelines beneath railroad property and (2) by lobbying successfully in Congress for six years against legislation that would confer eminent domain authority upon pipeline companies.

Coal pipeline technology is not complicated or new. Coal is simply ground into a powder, mixed with water, and pumped in slurry form through underground pipelines to its destination—a utility, major industrial plant, or port. There it is dried for burning as a primary fuel, or it could be pumped directly into a ship of special design. The first U.S. coal pipeline was built in Ohio in 1957, but was mothballed a few years later when the railroads in the area developed the unit-train approach and lowered their rates for moving coal. The second, and currently the only coal pipeline operating in the United States, is Black Mesa. Built in 1970 by a subsidiary of the Southern Pacific, it has been moving coal from northeastern Arizona to a power plant in southern Nevada for ten years with 99 percent reliability. Eight more coal pipelines are planned, but their development is made difficult or impossible by the rights-of-way problem.

The question is—should Congress grant eminent domain authority to pipeline ventures? The power of eminent domain is of course a sovereign prerogative, but may be conferred upon a designated third party to acquire property for a purpose that is in the public interest. In the past the granting of such authority has enabled the building of oil and gas pipelines, long-distance electric transmission lines, and of course the railroads themselves. At issue, then, is whether coal pipelines would serve the public interest.

Already in financial distress, the railroad industry sees rising demand for coal as the key to its revitalization. The railroads currently transport approximately 450 million tons of coal a year, almost two-thirds of the coal burned in this country. They argue that slurry pipelines would be a redundant transportation system, that rail transport is more versatile, and that a healthy railroad industry is vital to the nation. Their concern is that competition from coal pipelines would reduce their coal traffic (or the increase in that traffic) and keep rates at moderate levels, thereby dealing a crippling blow to their industry's recovery efforts.

Coal pipeline supporters respond that, with worldwide demand for coal growing rapidly, there should be enough business for all competing methods of transportation. If U.S. coal production doubles in ten years to 1.4 billion tons, and if all the coal pipelines now planned are built, the pipelines would be carrying only 150 to 170 million tons by 1990, leaving the railroads with almost two times more tonnage to move than they move today. Indeed pipeline supporters question whether the railroads, which are struggling now to carry the existing coal traffic, can even generate the capital needed to expand their systems sufficiently to handle their share of the projected increase.

The railroads also argue that federal eminent domain authority is not necessary for slurry pipelines. At least one coal pipeline company, they point out, has been able to obtain the needed "windows" through railroad surface rights-of-way in the West. Pipeline advocates counter, however, that these "windows" are often in locations that produce a circuitous route. Also, they can be obtained only in the West and only



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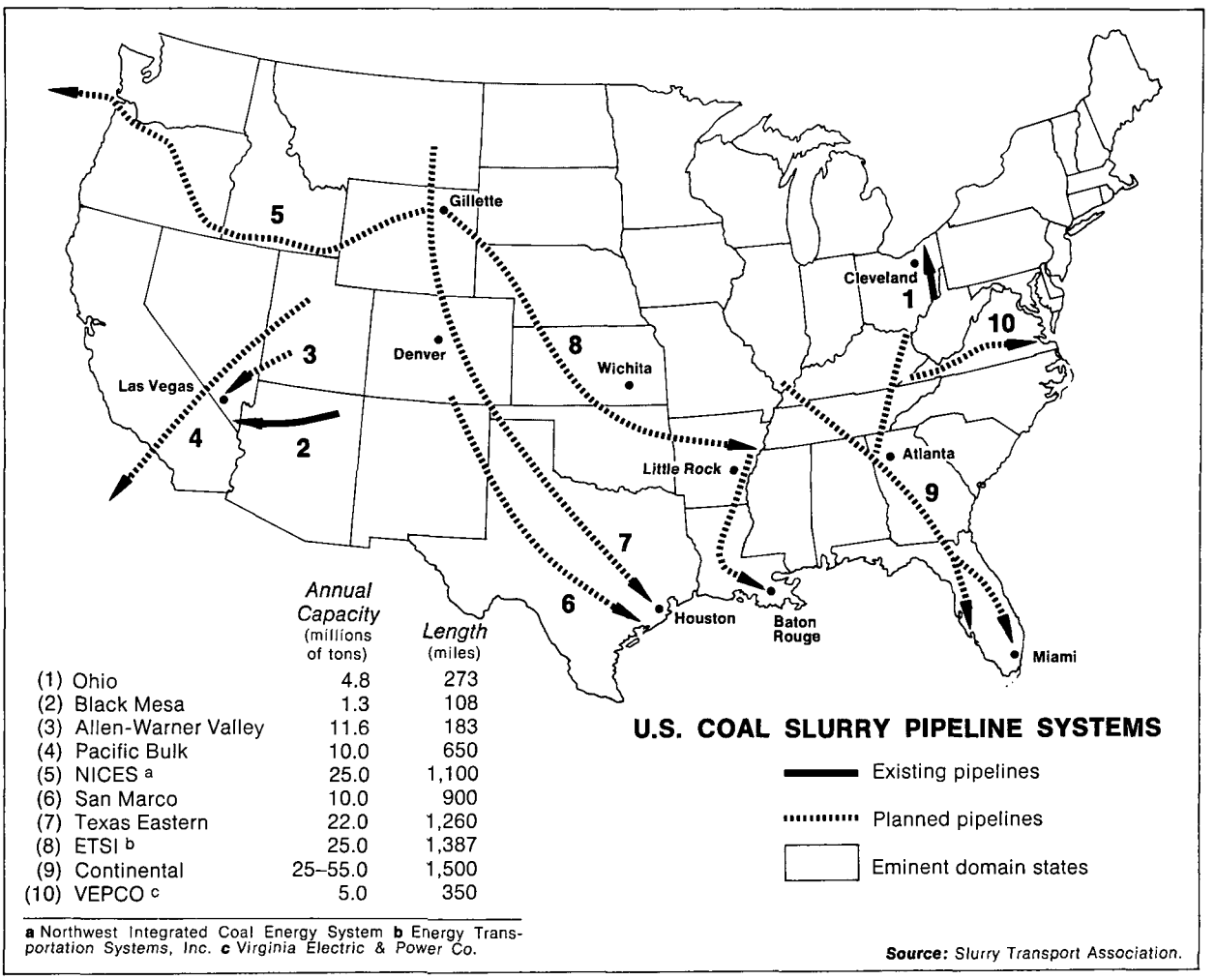


| | Annual Capacity (millions of tons) | Length (miles) |
|---|---|---|
| (1) Ohio | 4.8 | 273 |
| (2) Black Mesa | 1.3 | 108 |
| (3) Allen-Warner Valley | 11.6 | 183 |
| (4) Pacific Bulk | 10.0 | 650 |
| (5) NICES [a] | 25.0 | 1,100 |
| (6) San Marco | 10.0 | 900 |
| (7) Texas Eastern | 22.0 | 1,260 |
| (8) ETSI [b] | 25.0 | 1,387 |
| (9) Continental | 25–55.0 | 1,500 |
| (10) VEPCO [c] | 5.0 | 350 |

**a** Northwest Integrated Coal Energy System **b** Energy Transportation Systems, Inc. **c** Virginia Electric & Power Co.

**Source:** Slurry Transport Association.

through long and costly litigation, successful because some western states (nine, in fact) have eminent domain laws for coal pipelines and because not all of the railroads' rights-of-way in the West are owned in fee simple. But in the East, by contrast, only a few states have such laws and railroads have complete title, so that any crossing by competitive transportation systems can be effectively prevented. Thus, if the pipelines are left to piece out their routes as best they can under existing law, eastern coal-producing regions would suffer a distinct transportation disadvantage. (This argument loses some of its emotional appeal when one reflects that the eastern states' disadvantage is of their own making, since they can enact eminent domain laws of their own.)

Finally, coal pipelines raise the issues of water and the environment. The slurry process uses huge amounts of water—one ton for each ton of coal. For this reason the western states, whose water tends to be scarce, insist that any eminent domain legislation should in no way abridge state water rights. As for environmental issues, the problem of what to do with the "dirty" water after it has been re-separated can be handled, according to the Environmental Protection Agency, by treating it for various uses (like cooling systems) as well as for discharge. There also exists a more general environmental concern about the adverse effects of expanded mining and burning of coal—a concern now somewhat eased by the implementation of strip mining and air pollution laws.

Coal pipeline enthusiasts, for their part, claim substantial economic advantages for their ventures. First, pipelines are an inherently efficient transportation mode. The line proposed by Continental Resources Co. for moving coal 1,500 miles from the Kentucky region



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to Georgia and Florida is projected to save electric consumers $4 to $8 billion in fuel transportation costs in the 1990s. Approximately two-thirds of the cost of operating a pipeline stems from the fixed costs of construction. Once in the ground, the highly automatic aspects of a pipeline give it an inflation advantage over the railroads, whose cost structure is heavily weighted by inflation-sensitive factors —labor and fuel. Second, because slurry pipelines can be easily interconnected with barges and other vessels, one can foresee the development of new, efficient systems for the loading and ocean transport of coal. Their use would help relieve existing bottlenecks at traditional export sites, which is necessary if any major expansion in coal exports is to occur. Third, pipeline promoters are not asking for any federal subsidy; in addition, while sale of rights-of-way would be compelled by federal eminent domain power, the companies would have to purchase the rights at fair value.

With coal pipelines now proposed in the East as well as the West, legislation to facilitate their development is no longer a regional issue and is gaining support. Nevertheless, the prospects for passage this year appear dim.

The coal pipeline controversy, however it may be resolved, is a refreshing reminder that federal governmental powers are useful not only to restrain but also to facilitate productive economic activity. Come to think of it, that was one of the principal purposes for their creation. In the present instance, the benefit promised is a national one, but regional or (in the case of the railroads) competing economic interests prevent its achievement. Of the objections to invocation of federal power, surely the environmental protection and water-use issues deserve to be considered. That is to say, those objections must be met on their merits—for if we ought not to be mining and burning huge quantities of coal or consuming huge quantities of water for those purposes, the rights-of-way legislation has no legitimate claim on our national attention. The issue of railroad viability, on the other hand, does not belong in the debate. Even if it is in the national interest to subsidize the railroads, there is nothing to be said for applying that subsidy through the preservation of economic inefficiences—nothing, that is, except the fact that it renders the burden of the subsidy invisible, immeasurable, and inequitably distributed among our citizens. Instead of pressing their case against coal pipelines, the railroads would be better advised to rest content with the not inconsiderable advantage that greater competition in coal haulage can provide: namely, the increased assurance that they will be able to reap the benefits of their own deregulation. Their newly enhanced rate flexibility will be less subject to regulatory frustration and political attack to the degree that the marketplace gives consumers alternate methods of transportation.

It would be ironic if the present Congress, which has done much to end the technique of subsidy-via-inefficiency as practiced by the ICC, should itself embrace that technique.

## Legislative History Reconsidered

Federal legislation authorizing regulatory programs has provided some significant victories for those who decry a narrow, textual approach to statutory construction and support the most far-ranging judicial inquiry into legislative intent. The "plain-meaning rule" has been an intellectual laughing stock ever since a statute prohibiting the interstate transportation of any woman for an "immoral purpose" was used to convict a California politician's son for taking his girlfriend to Reno, Nevada, for a night of unconnubial bliss. Cases involving the authority of the Interstate Commerce Commission, the meaning of the antitrust laws, the interpretation of tax statutes, and the authority of the Environmental Protection Agency have been among those illustrating the creative uses of legislative history to produce results not only unapparent but even implausible to one eying the words of the statute alone.

At a time when regulation was regarded as an unmitigated good, this judicial willingness to look behind a statute's words was natural enough. The use of legislative history would enable "fine tuning" of regulatory programs—to cover situations not envisioned by the statutory language and to provide a safeguard against the manipulativeness of lawyers and their clients. Often the responsible agency would be deeply involved in the drafting process, and the legislative history would bear revealing traces of that activity.



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With today's fresh enthusiasm for deregulation, one might expect something of an about-face, and it appears to be occurring. In a number of recent opinions, the Supreme Court has construed agency authority restrictively, giving far more attention to the limited words of the statutes involved than to general expressions of facilitative purpose in the legislative history. In such cases as *Tennessee Valley Authority* v. *Hill* (1978) and *Securities and Exchange Commission* v. *Sloan* (1978)—the Court has appeared to take the position that the "literal or usual meaning" of a statutory provision is binding on the courts unless it would lead to absurd results or would thwart the obvious purpose of the statute. Congress, in other words, must be taken to have meant what it said in enacting the statute, and not given the benefit of any second thought that might appear to emerge from the legislative history unless some indication arises from the textual source that reference to that material is or might be helpful. The legislative effort of Senator Dale Bumpers (Democrat, Arkansas) to overcome "the presumption of validity" which he believes now attends agency action would capture this rule in statutory form for questions of agency authority: not unless a grant of agency authority appears clearly on the face of the statute, or in light of the statutory text and strong legislative history, would an agency be considered to have the authority for challenged regulatory action. Plainly, when regulation is no longer an unquestioned benefit, it becomes more appropriate to require agencies to demonstrate clearly the premises on which they act.

A recent decision of the U.S. Court of Appeals for the District of Columbia (also, incidentally, in the service of deregulation) illustrates yet another reason for increasing judicial skepticism about the uses of legislative history. *National Small Shipments Traffic Conference* v. *Civil Aeronautics Board* (1980) involved a challenged rule that exempted domestic air-cargo carriers from filing tariffs with the CAB, from providing air transportation service on reasonable request, and from filing their agreements with other carriers affecting domestic air transportation. The rules in question were adopted in response to the cargo deregulation provisions of the 1977 Amendments to the Federal Aviation Act, provisions that completely overhauled federal regulation of the air-cargo industry. Those provisions eliminated virtually all CAB control over entry into the air-freight business and most controls over rates; they also gave the CAB broad authority to grant exemptions from other regulatory requirements. The board's authority to issue the rule was plainly supported by a literal reading of the exemption clause.

The air-cargo deregulation proposal had received scanty consideration in Congress. It was introduced on the floor of the Senate as an amendment to a bill dealing with an entirely different subject, already passed by the House. When the bill thus amended went to conference, the conference committee agreed to the cargo deregulation provisions, which therefore came before the House on the motion to adopt the conference report. The only written legislative history in either house was the conference report. And that report stated:

> The Managers do not contemplate that the Board will exempt carriers from the requirement of filing tariffs. Tariffs provide valuable notice of rates to users of air transportation. Tariffs will be necessary for the Board to effectively carry out its duties to determine whether rates for the transportation of property are discriminatory, preferential, prejudicial, or predatory.

Conference reports have long been regarded as a very strong form of legislative history; they appear in printed form—before both houses of Congress—and are generally thought to be accepted in both places as reliable indicators of the bill's meaning. Particularly because of the unusually hasty and uninformed legislative action on this bill, one might have thought that the conference report's assessment of what is "necessary for the Board to effectively carry out its duties" under the legislation would carry especially great weight. Then, too, the subsequently enacted Airline Deregulation Act of 1978—which, though it did not deal with cargo questions directly, was part of the same deregulatory movement as the statute under which these rules were adopted—supported the challengers' arguments that Congress contemplated a *gradual* course of deregulation, with a retention of tariff filing requirements.

The D.C. circuit court put this legislative history aside in the face of statutory language



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clearly authorizing the board's action. Its refusal to rely on the conference report struck a broader—but well-warranted—note of skepticism about the uses and abuses of legislative history. "Courts in the past," the court observed,

> have been able to rely on legislative history for important insights into congressional intent. Without implying that this is no longer the case, we note that interest groups who have failed to persuade a majority of the Congress to accept a particular statutory language often are able to have inserted in the legislative history of the statutes statements favorable to their position, in the hope that they can persuade a court to construe the statutory language in light of these statements. This development underscores the importance of following unambiguous statutory language absent clear contrary evidence of legislative intent.

Few are likely to propose a return to the days of unthinking, uncritical reading of statutes. Context and general purpose have unquestioned importance, and indeed on reading the court's opinion in *National Small Shipments* one is struck that each received its fair due. But—particularly with the burgeoning of congressional staff and well-financed legislative lobbying—abuses of legislative history have become commonplace. Passages in some committee reports address subjects nowhere discussed in the bill; others, like the one in the air-cargo case, express desires for implementation that their authors were unable or unwilling to reduce to statutory requirements. Costly hours and large amounts of resources are thrown into the effort to influence the committee report as well as the statute itself. And of course Congress does not enact these reports. Even the proposition that they are read, rather than prepared for their possible impact upon later events, is increasingly an amiable fiction —at least if the reader is supposed to be the harried senator, the person who actually casts a vote. The senator will have time only for a hasty conversation with an aide, who will have no time to explain whether tariffs will, or will not, continue to have to be filed.

The basic problem *is* one of balance. Members of Congress, their staffs, and those who try to influence them cannot help noticing that congressional reports have their uses, not only within Congress, but also after Congress has finished its work. If one is persuaded that the use within Congress predominates, then it makes sense to rely upon these materials as significant indicators of the meaning of the legislation to which they refer. At one time, this was undoubtedly the proper assessment. But it is an elementary principle of science that the effect of observation may be to render imprecise, even alter, that which is being observed. Seeing that congressional reports were influential upon later events, those who wished to shape those later events inevitably turned their attention to shaping the congressional reports. Noting this, the D.C. circuit has quite properly suggested greater caution in the future use of committee and conference reports as instruments of judicial interpretation.

## The Hospital Industry's New Vulnerability to Antitrust

Having long been spared close scrutiny by antitrust enforcers, health-care institutions have grown accustomed to allocating markets by mutual agreement rather than by market competition. Some government agencies, convinced that effective competition is unlikely, have condoned, even supported, the practice.

In May 1980, however, the Antitrust Division of the Department of Justice denied its imprimatur to such collective decision making not sanctioned by explicit statutory authority. That denial appeared in an Antitrust Division "business review" letter advising the Central Virginia Health Systems Agency (the federally funded planning agency for the Richmond area) that the department could not rule out antitrust challenges to CVHSA-sponsored agreements among competing hospitals—even agreements intended to eliminate "excess capacity" identified in CVHSA's local health plan.

CVHSA is not the only health systems agency (HSA) that has sought to eliminate "excess" capacity by inducing hospitals in its area to negotiate voluntary agreements. HSAs generally view such arrangements as valuable tools for bridging what they regard as a gap in the planning program. The planners note that state certificate-of-need agencies, which regulate *new* capital investment in the health-care sector, are



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not authorized to eliminate *existing* excess capacity and thus are powerless to make the quantity and configuration of health services conform to health plans. Therefore, some HSAs —which are not government agencies at all but rather private, nonprofit corporations set up as advisory bodies by the planning law—have undertaken the task themselves. An apparently effective technique has been to persuade two institutions to enter into a so-called closure agreement whereby only one will offer a service currently being offered by both. Thus, one hospital might agree to give up its inefficiently small maternity service if another will agree to close its lightly used emergency room.

In refusing to bless the planners' practice of brokering agreements not to compete, the Antitrust Division addressed the issue primarily as a technical question of statutory construction—that is, whether Congress created an implied antitrust exemption for such agreements when it passed the health planning legislation in 1974 and amended it in late 1979. The principles for determining whether an implied exemption exists are well established. Implied exemptions are not, the courts have held, to be found lightly but only where they are necessary to enable regulatory programs to work as Congress intended; and their scope is to be no broader than that objective demands.

Although the 1974 federal planning law calls upon HSAs to "reduce documented inefficiencies, and [to] implement [their] health plans . . . with the assistance of individuals and public and private entities . . . ," the Justice Department concludes that this does not clearly indicate that HSAs are to implement their health plans by brokering agreements among competitors. In the department's view, the provision cited is entirely consistent with Congress's having envisioned only *unilateral* decisions to withdraw from the marketplace. The legislative history of the 1979 amendments provides some support for this position. Although the relevant committees were briefed on the then-pending CVHSA issue and the Department of Justice's likely opinion, they did not draft a statutory exemption for the disputed activity, nor did they endorse it in their committee reports. The closest they came to addressing the issue was a statement in the House report that HSA actions "necessary" to carry out statutorily "prescribed" functions are exempt, while those that are not necessary "are not authorized and therefore not immune from the application of the antitrust laws."

Despite what it clearly regards as firm legal foundation for its conclusion that HSA-sponsored market allocation is not exempt from the antitrust laws, the Department of Justice went out of its way in the business-review letter to speak in cautious—even conciliatory—tones. But this did not mollify planning groups. Assisted by the Department of Health and Human Services, they quickly began to marshall new arguments for immunizing HSA-sponsored closure agreements. The most important of the new arguments is founded on the proposed regulations for implementing the 1979 planning amendments. These would require health-care institutions to obtain the approval of the state certificate-of-need agency before terminating a service or closing a facility. Planners argue that this assurance of government scrutiny and approval would provide the necessary protection against undesirable closure agreements. They also argue that, under such a scheme, any proposed closure agreements that were submitted to such an agency could be considered part of legitimate efforts to petition the government, and thus be exempt from antitrust laws.

The recent decision of the Eighth Circuit Court of Appeals in *National Gerimedical Hospital and Gerontology Center* v. *Blue Cross of Kansas City* (July 1980) will also bolster the planners' position. The court held that Blue Cross does not violate the antitrust laws when it denies "member hospital" status to institutions built without the approval of the appropriate HSA. To reach that decision, the court carved out a broad antitrust exemption for private firms working with HSAs in pursuit of the general goals of the planning act.

If, as expected, the Department of Justice holds to its current position, the planners could still prevail by pressing their case for an antitrust exemption in the next Congress. That would present the basic issue in its starkest form—whether a system of HSA-conferred exemptions from the antitrust laws is compatible with the preference for competition expressed in the 1979 health planning amendments. (See Clark Havighurst and Glenn Hackbarth, "Competition in Health Care: Planning for Deregulation," *Regulation*, May/June 1980.)



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# Viewpoint

## *A Democrat looks at the Republican platform*

# STUART EIZENSTAT

THE REPUBLICAN platform is schizophrenic on regulation. The goals of the great 1964–1977 wave of social legislation are endorsed. But the vehicles to get us there—the needed implementing regulations—are treated as engines of economic disaster. The Republicans' "solution" is to immobilize the regulatory process in a morass of procedure.

Both parties put high priority on regulatory reform as part of their long-term programs to strengthen the economy and governmental effectiveness. But their approaches are very different. The Democrats would continue and expand the reform efforts of the last four years: more of the economic deregulation accomplished by President Carter and Congress, and better management of social regulations—as initiated by the President's Executive Order 12044—to make them cost-effective and consistent. The Republicans brush past the first of these areas and seem to want to paralyze the second.

**The Republican platform is schizophrenic .... The goals of ... social legislation are endorsed. But the vehicles to get us there ... are treated as engines of economic disaster.**

Economic deregulation has been on the agenda for decades but the real push began only five years ago. First steps by the Ford administration and Senator Edward Kennedy have accelerated since 1977 into a steady march. Five major bills plus hundreds of agency actions are thinning federal regulations and freeing competition in airlines, energy, trucking, railroads, banking, broadcasting, cable TV, telecommunications carriers, and other areas. In addition, state rules and professional codes that restrict competition among doctors, druggists, and eyeglass dealers are being attacked. The airline and trucking reforms alone will save consumers an estimated $6–10 billion a year. There is more to be done. But the Republican platform notes merely that "the marketplace should regulate management decisions," and endorses—without getting down to any controversial specifics—deregulation in energy, transportation, and communications.

The GOP platform's skimpiness in this area and its silence on how to finish the job may reflect understandable reluctance to discuss Carter successes. GOP support certainly was crucial to passage of the deregulation bills, and we wish to continue this bipartisan partnership on economic deregulation. But Governor Reagan's courtship of the foes of trucking deregulation and his silence on other specifics is worrisome. In September, when the President was fighting to pass the railroad deregulation bill, Governor Reagan's definitive economic policy statement called only for a "task force" to decide which industries need deregulating.

The Republicans do focus on reform of the regulatory process, but they ignore the changes

*(Continues on page 19)*

*Stuart Eizenstat is assistant to the President for domestic affairs and policy.*



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*A Republican looks at the Democratic platform*

# CALVIN J. COLLIER

THE CONVENTIONAL political wisdom is that party platforms should rally the faithful, view the opposition with alarm, attract almost everyone, offend almost no one (except oil companies)—and generally hold out the promise of an endless supply of free lunches and generous slices of Mom's apple pie.

The 1980 Democratic platform is no exception. With regard to regulation, it divides the universe into "good" and "bad" and declares victory over the "bad": regulatory reform, which wipes out intrusive burdensome regulation, is all but an accomplished fact, and the regulatory future will be limited only to what is "reasonable" and "necessary"—"vigorously enforced."

That at least is the way the platform reads. How it "feels" is something else again. Here I must admit to using a measure of interpretative license —some, but not much. Insofar as the platform is vague, which is most of the time, inferences based on experience are all we can rely on. Insofar as the platform makes firm commitments, its message is plain and it is consistent. The platform comes down repeatedly on the side of the regulatory hawks. Its thrust is away from private decision making (anti-business is not too strong a characterization) and toward the superior wisdom of the regulator. It promises no break with the growth of increasingly comprehensive and detailed regulation—just finer tuning and better management. Only in the area of traditional economic regulation—old-fashioned transportation and public utility regulation—is there much of a commitment to less of it, and a weak one at that.

The platform praises the Carter administration for its role in airline and trucking deregulation. It goes on to endorse *some* of the same medicine for the ailing railroads and calls for a "revamping" (no specifics) of banking and telecommunications regulation. Common to them all will be more reliance on competition and less on government fiat to set prices, mandate quality, introduce innovation, and regulate firms' entry into and exit from the marketplace. But in light of the record of recent years, the commitment to relax such regulation for a few industries (but not for ocean shipping or oil-and-gas production, to name just two) is scarcely novel and certainly not bold.

The fact is that both parties have supported the selective dismantling of this kind of economic regulation for some time. The evidence is overwhelming, especially for industries with no bent toward natural monopoly, that public utility-type regulation fails to improve product or service quality and that it creates costly distortions and misallocations by interfering with market forces.

**The [Democratic] platform comes down . . . on the side of the regulatory hawks. Its thrust is away from private decision making . . . and toward the superior wisdom of the regulator.**

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In any case, the proposals in question were first put forward by Republican administrations, blocked for years by Democratic-controlled congresses, and eventually enacted with Republican support. Thanks to the Democrats' quite recent conversion (or a closer reading of public opinion survey data), the continuing fight to deregulate these industries does not pit Democrats against Republicans but, rather, majorities of both parties against unlikely alliances of the regulated industries themselves and a congeries of special pleaders.

### Increased Economic Regulation

The Republicans have not yet succeeded, however, in dragging the Democrats along into economic deregulation on other fronts. The Democratic platform is exhibit one. It contains an amazing assortment of new and expanded regulatory proposals whose reach far exceeds that of the programs targeted for reform. Consider this depressing laundry list:

**The Republicans have not yet succeeded . . . in dragging the Democrats along into economic deregulation on other fronts. The Democratic platform . . . contains an amazing assortment of new and expanded regulatory proposals whose reach far exceeds that of the programs targeted for reform.**

- Expanded price and manpower controls for health services, including "aggressive cost containment," new rules for health insurance, and "redistribution of services" to aid "underserved areas";
- Continued price controls for oil and gas, along with stand-by gas rationing and "massive" incentives and grants to improve energy efficiency in residences, industrial processes, and transportation;
- Entry restrictions that would "phase out foreign fishing" within the 200-mile limit and control farmland purchases by "speculators," foreigners, and agribusiness;
- More entry restrictions, this time in the form of limitations on the freedom of large firms and oil companies to expand into new industries through acquisitions;
- Direct regulation of product or service quality by mandating automobile warranty levels, stronger portability features for pension programs, energy-performance standards for *all* new buildings, and codes of conduct for debt collectors;
- Indirect regulation of quality by mandating that information be disseminated (or, sometimes, by prohibiting the disclosure of information) about food ingredients, sale of credit life insurance, employment recruiting and promotion, granting or denying of credit, and consumer credit agreements;
- Regulation of labor by preserving the Davis-Bacon Act (whose effect, by fixing wages above competitive levels, is to encourage inflation and unemployment) and by opposing the inclusion of a youth differential in the minimum wage (which protects experienced workers by reducing jobs for inexperienced youths).

Quite a list—particularly for a platform that elsewhere applauds "an effective competition policy" that "frees the marketplace from regulation." Apparently, the competition that is good in general (and needs to be increased for airlines, trucking, railroads, banking, and telecommunications) just will not do for a much longer list of other areas (health care, oil and gas, health insurance, fishing, farmland and business acquisitions, automobile service, pensions and life insurance, building construction, debt collection, recruiting and hiring, credit, construction wages, and youth employment). Yet the proposed economic regulations for these areas, most of them transparent appeals to powerful single-issue constituencies, would have much the same adverse effects as public utility regulation. For example, price controls invariably distort production levels, with artificially high prices restricting economic activity (by discouraging demand and reducing jobs) and artificially low ones (which the Democrats propose for health services and oil and gas) reducing supply. Entry restrictions reduce efficiency by excluding potentially the most efficient producers from the market. And direct and indirect regulation of product quality, the very image of price regulation in its effects on economic efficiency, forces some consumers to pay for a level of quality (or information) that exceeds their demand.

These costs are of course imposed on the economy as a whole—indeed on the populace as a whole—but initially at least on some groups more than others. The direct and immediate "losers" generally suffer in ignorance because their losses are measured by products or services that were never produced or that carry a hidden regulatory tax. The direct and immediate beneficiaries, on the other hand, usually know who they are. What they may not realize, however, is that they might be beneficiaries only in the short term, because the overall economic deterioration that ultimately re-



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sults from such regulatory techniques produces a net loss for almost all of us. They also may not realize that although they win on one program, they lose on so many others that their net position is likely to be in the red. Thus, while domestic fishermen would benefit from the Democratic platform's proposed 200-mile rule, they would be among the numerous losers of the other schemes for benefiting special groups.

The so-called regulatory winners in the platform include, in addition to the fishermen, heavy users of medical services and petroleum, some high-risk users of health insurance, farmers (except those wishing to sell their farms), sundry businesses in less efficient industries, motorists who shop poorly, employees (probably older ones) who wish to change jobs, homeowners with poor conservation habits, consumers who fail to pay their debts, people who read labels, unionized construction workers, employees whose job skills are little better than those of unemployed youth, plus employees, job applicants, and would-be debtors who are high risks.

The platform also calls for changes in antitrust law. Antitrust, its proponents claim, promotes efficiency by preserving competition, and there is some truth to the claim. But it is not always so. Much of antitrust law either is intended to discourage efficiency by protecting particular competitors or has been enforced with that effect. So proposals to "expand" or "toughen" antitrust must be scrutinized carefully. The Democratic platform calls for new laws (1) to prohibit acquisitions by large companies in general, and oil companies in particular, without regard to whether these acquisitions enhance or lessen competition, (2) to enlarge greatly the class of persons who may prosecute antitrust claims for treble damages, (3) to allow individuals to enforce government consent decrees, and (4) to eliminate present requirements for proving an agreement or conspiracy as a predicate to liability of firms engaged in parallel behavior.

These measures would not necessarily enhance competition, and could even have the very opposite effect. The anti-conglomerate/anti-oil company merger proposal is aimed at acquisitions that, by implication, cannot be shown to be anticompetitive. Expanded standing for antitrust treble damage suits would surely raise the cost of antitrust litigation without much deterring anticompetitive behavior. Eliminating proof of anticompetitive agreements would make it possible to condemn industry conduct that is not anticompetitive. And private enforcement of antitrust consent decrees would be beneficial, if at all, only in those cases where the decrees themselves promoted competition—by no means a universal situation. In large part, the platform's antitrust proposals are simply economic regulation parading under the banner of competition.

### Environmental and Health Regulation

As interventionist as the Democratic platform is in the economic area, it is even more so when it turns to environmental, health, and safety regulation. There are insistent and repeated calls for major increases in the quantity and stringency of government controls. For example:

- "Vigorous enforcement" of auto pollution regulations and toxic substances controls;
- "Elimination" of acid rain pollution;
- "Fighting" noise pollution;
- Opposition to any efforts to "weaken" occupational safety and health regulation (including opposition to small business exemptions);
- Opposition to authority for federal agencies to override or exempt state or federal protections of the environment or public health and safety; and
- Additional unspecified protection in the areas of auto safety and clothing flammability standards, new drugs and chemicals, food, and children's products.

In this regulatory area, the platform reveals far more than it says. The question here is not the attractiveness of the goals, but the costs to society of the pursuit of absolute purity and zero risk. Regulatory doves argue for improved benefit-cost analysis, repeatedly document the fact that many regulations do not achieve their goals (or do so only at unreasonable cost), and raise fundamental questions about the efficacy of certain types of regulation (for example, design standards tied to particular technologies). Regulatory hawks resist benefit-cost analysis altogether, arguing that the benefits are beyond price or that the state of the analytical art is too primitive to be useful. But the 1980 Democratic platform finesses the entire debate. While calling for improved analysis to lower regulatory costs, it reduces this difficult task to an all but meaningless exercise in wish fulfillment by simply declaring, quite without proof, that environmental regulation has been a success and that health and safety regulation has significantly reduced work-place accidents and fatalities. Probably wrong on both counts—and worse, such evasions miss the target altogether. At a time when Congress, the public, and the experts all are seriously rethinking fundamental questions—when even the Carter administration is promising stretch-outs in certain regulations to stimulate economic recovery—the platform looks back. Its anachronistic return to the regulatory spirit of the



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1960s and 1970s flies in the face of mounting evidence that, whatever the spirit, the approach just did not work.

**Regulatory Management**

In its principal gesture to regulatory reform, the Democratic platform endorses a long list of procedural proposals to improve—or so it claims—regulatory management. These are the major elements:

- Review of existing regulations;
- Analysis of the predicted impact of regulations before they are issued;
- Consideration of alternative approaches that might cut compliance costs;
- Publication of forthcoming rulemaking proposals in a regulatory calendar; and
- Increased public participation in regulatory proceedings.

The Carter administration has claimed credit for all of these procedural reforms, and Republicans have generally supported them. (Two of them, in fact—improved economic analysis and increased public participation—are direct descendants of President Ford's own regulatory reform program.) But years after their introduction it is still difficult to judge their worth. Because they add to the regulators' workload, they probably prolong the rulemaking process. It is not clear, however, that they have improved the quality of regulations, either by increasing benefits or reducing costs. Yet the platform, without supporting argument, pledges to "continue" to "make regulation less intrusive and more effective" and to "increase the use of cost-effective regulatory techniques." Moreover, its failure to endorse benefit-cost analysis expressly and its refusal to require that the benefits of regulation match—or even reasonably relate to—their costs suggest that little progress has been made in four years. Without these commitments, analysis is mostly an expensive exercise in futility.

Other items on the Democrats' procedural reform agenda are just as worrisome. One is the somewhat surprising resurrection of the independent consumer advocacy agency—a scheme firmly laid to rest two years ago by a Democratic-controlled Congress (with Republican assistance). A second procedural item that would increase regulation is the call for expanded use of class actions in federal courts. Consumer activists see these suits as powerful weapons for regulating enforcement; defendants generally view them as burdensome tools of lawyers in search of huge fees. Still another procedural proposal calls for expanded consumer standing to challenge regulatory action —which obviously means to petition the courts to increase the amount and severity of regulations.

If there is any remaining doubt that the Democrats' vague commitments to regulatory reform promise more regulation, not less, it is resolved by the platform's praise for President Carter's appointment of consumer advocates to key regulatory positions. In basic Washingtonese, a consumer advocate is a regulatory hawk, and key regulatory positions are those from which the hawks wield broad—and increased—regulatory authority. Because so many statutes are as vague as the Democratic platform itself concerning the extent of the regulations they propose, and because the likelihood of their being redrafted to limit regulatory discretion is very slight, it is those who manage the programs who essentially determine the intensity and burdensomeness of regulation. And on this score, the platform's signal is clear.

**... any remaining doubt that the Democrats' vague commitments to regulatory reform promise more regulation ... is resolved by the platform's praise for President Carter's appointment of consumer advocates to key regulatory positions.... [A] consumer advocate is a regulatory hawk....**

WHERE ARE WE THEN, when all the claims have been weighed (and found wanting) and all the "winners" and "losers" have been balanced out? We are left, in my judgment, with the threshold issue of the direction in which American society should be moving.

The 1980 Democratic platform is, in this view, a tired repetition of the policies that have contributed so much to our current economic malaise. What ultimately is at issue—and here I borrow with pleasure from a striking analysis by Representative Dave Stockman of Michigan (*Washington Post*, July 15, 1980)—is "the excessive *politicization* of our national life . . . the tendency to resolve almost everything in . . . national legislative and administrative forums . . . [rather than in] the daily exchanges and decisions of the marketplace." (His italics and his rich insight.)

Now it may be true that if philosophers were kings and kings philosophers, we would not be amiss in turning always "to Washington" for political wisdom. In the meantime, however, we might do better to preserve and strengthen the engines of a free and private economy. ■



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**Eizenstat on the Republican Platform**
*(Continued from page 14)*

already under way. They say "small business should be exempt or subject to a less onerous tier of regulation." The President ordered this policy in 1979, dozens of regulations are now being "tiered," and the Congress has just passed (and the President signed) the Regulatory Flexibility Act which makes the policy law. The Republicans want cost-benefit analysis of major new rules and review of existing regulations to eliminate the outmoded and duplicative. For more than two years, Executive Order 12044 has imposed a management framework on the regulatory process, including analysis of the costs and benefits of major new rules, a requirement that agencies select the least burdensome way to achieve the regulatory goal, and hard-eyed reviews of existing regulations; and the administration is seeking passage of the Regulatory Reform Act, which incorporates those reforms into statute and extends them to the independent regulatory commissions. The GOP attacks paperwork and wants agencies to "justify every official form." President Carter has ordered careful scrutiny of all paperwork requirements, has cut the paperwork burden by 15 percent, has established a "paperwork budget" (modeled on the spending budget) to make more cuts, and has proposed legislation to strengthen the authority of the Office of Management and Budget to control paperwork. (One footnote on this subject: over two-thirds of the burden is created by a single agency, the Internal Revenue Service. The Republicans' call for dozens of new tax expenditures—and no closing of tax loopholes—would add more complexity to tax forms than might be cut from the rest of government put together.) The Republicans also endorse sunset legislation, a proposal that the President has backed for several years.

The platform ignores another key area of generic reform—executive oversight and coordination. In the past three years, the Regulatory Analysis Review Group has acquired legitimacy as a way to put White House concerns about proposed rules on the public record. OMB's new Office of Regulatory and Information Policy is overseeing E.O. 12044 compliance and running the "paperwork budget." And the Regulatory Council is providing the first government-wide calendar of upcoming rules and coordinating the agencies' actions on issues that cut across their jurisdictions. Congress and the administration are assessing the advisability of next steps, such as creating a "regulatory budget." Some say such a process is needed to control overall costs and set sensible priorities. Others think that calculating the compliance cost of all new and existing rules—in a way that permits the Environmental Protection Agency's costs to be compared with the Interstate Commerce Commission's, for example—would impose huge burdens on the agencies and the regulated industries, generate distorted data, overload Congress, and have little practical effect on most regulations. The Republican platform casts no light on these matters. Indeed, the GOP seems indifferent to the real uses of the administrative power it is trying so hard to capture.

**Marching into the Morass**

The Republicans take a very different approach. Their platform endorses a string of ideas circulating in Congress to use the legislative and judicial branches to enmesh the executive branch in red tape. Their idea of procedural reform includes:

- "Strict budgetary controls" on the regulatory agencies;
- "A temporary moratorium on all new Federal regulations that diminish the supply of goods and services and add significantly to inflation";
- The legislative veto;
- Judicial review prior to the exhaustion of administrative remedies;
- Legislation to "eliminate the present presumption of validity in favor of Federal regulations";
- A requirement that an agency's decisions be consistent with prior actions unless otherwise provided by law; and
- Restitution (from the Treasury) for anyone "wrongfully injured" by an agency action—whatever that means.

While the platform recognizes the need for social regulation and endorses its goals, these procedural proposals suggest the GOP is not interested in actually managing regulation. Consider, for example, how a Republican-led Occupational Safety and Health Administration would respond to new evidence showing workers are exposed to a carcinogen. According to the platform, Republicans recognize "the need for governmental oversight of the health and safety of the workplace without interfering in the economic well-being of employers or the job security of employees." If this means the GOP opposes all rules that cost money, then worker protection would stop. But let us assume that the GOP would let OSHA take action on serious hazards.

First, in spite of "strict budget controls," OSHA must find the funds and the staff to develop the rule—and the research needed for proper evaluation of risk and cost can be expensive indeed. The Carter administration of course practices careful budgeting. But we disagree with the



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GOP's belief that regulatory costs can be cut by cutting an agency's budget and the size of the *Federal Register*. Such a notion is both misleading and dangerous. Agency budgets rise virtually automatically with costs and salaries and contain more money for enforcement, licensing, overhead, and the like, than for writing rules per se. And the *Federal Register* grows in large part because of the E.O. 12044 requirement that it contain more explanatory material than it used to. If the Republicans try to cut underlying compliance costs by slashing budgets, the result will be longer backlogs for permits, less research, less effort to improve existing rules, and less use of techniques such as performance standards that really can cut compliance costs but are expensive to enforce. And if the GOP tells the agencies that regulatory reform equals fewer *Register* pages, they may just give the public less information.

Let us assume, however, that OSHA somehow issues its rule. It then bumps squarely into the moratorium. The Republicans would have to create a central clearinghouse to decide whether a rule adds "significantly" to inflation and whether it is required by an emergency. This unit would find itself hip deep in lawyers arguing over how much cost is "significant" and how much harm constitutes an emergency. All new rules—good and bad—would disappear into the resulting backlog. Business uncertainty would be magnified. Not to worry, however: the moratorium idea has been urged repeatedly, but its sponsors keep forgetting that most regulations are mandated by statute. Most such statutes require agency decisions on the basis of specific factors, not overall economic considerations. A moratorium would have to be established by Congress, and the debate over which rules to include and which to exempt would be (like the backlog) endless. An across-the-board moratorium has as much chance of passage as a limit on the terms of members of Congress.

There is more Hill support for the Republicans' next procedural proposal—the legislative veto. The constitutional problems with this idea have been debated almost ad nauseam. It should be noted, however, that if Governor Reagan becomes President and sticks by his platform, he would be surrendering a piece of the presidency that his predecessors, Democrats and Republicans alike, have stoutly defended for fifty years. And then there are the practical effects. The legislative veto provision would delay the rule's effective date for sixty "legislative days" (three to six months), increasing uncertainty. To avoid a veto, OSHA probably would take its draft rule to its congressional oversight committees for backroom negotiations, thus undercutting the public comment process.

**. . . if Governor Reagan becomes President and sticks by his [platform's proposal for the legislative veto], he would be surrendering a piece of the presidency that his predecessors, Democrats and Republicans alike, have stoutly defended for fifty years.**

In the midst of all this, the Republicans would start court proceedings. Indeed, under their extraordinary proposal to drop the "ripeness" doctrine, lawsuits could start the day OSHA decided to work on the regulation. (To be sure, this arrangement does fit with the GOP plan to preclude judges from deferring to agency expertise. If the courts are to do all the work themselves, they might as well get a head start!) The litigation would be further enlivened by the requirement that all aspects of the rule be consistent with prior agency decisions. Presumably this means that OSHA could neither strengthen *nor weaken* any of its standards—regardless of new evidence—without getting a law passed. Meanwhile, the combination of a legislative veto and early-bird judicial review would help the Republicans escape blame. The ball would bounce back and forth among agency, Congress, and the courts so often that no one could be held accountable. The workers would be left with nothing but the GOP's restitution provision. If OSHA's failure to protect them were deemed an "improper action," they might be able to sue the government for their medical bills!

These procedures would retard the flow of regulations. They might even cripple regulation as a policy tool. But they would not make regulations more sensible—or more effective in accomplishing the goals the Republicans say they share. These procedures run directly counter to E.O. 12044's central theme, that better decision making *in* the agencies is the way to produce better rules.

### Reforms That Work

A major element of the Carter program is the requirement that agencies use, wherever possible, eight innovative alternatives to traditional, rigid "command-and-control" regulation: reduced requirements for small businesses, performance standards, economic incentives, marketable rights, voluntary standards, enhanced competition, information disclosure, and compliance reform. A recent Regulatory Council report lists 376 instances in which these techniques are being used to make regulations more flexible.



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These approaches require creativity and hard work. They often involve departures from precedent and lack specific statutory sanction. Agencies that use them have to expect criticism and litigation. But the savings can be tremendous. For example, EPA's "bubble policy"—setting pollution reduction targets plant-wide or area-wide instead of source-by-source—can cut compliance costs as much as 50 percent without sacrificing air quality goals. The Republican platform's substantive planks endorse this kind of approach for EPA and OSHA, but the procedural scheme would kill it. Or consider EPA's recent decision to exempt small sources from solid-waste disposal standards, a move that cuts loose 91 percent of those who are regulated but only 1 percent of the wastes. Nothing in the law specifically authorizes this policy change, so the GOP's judicial review proposal could kill it. Similarly, the GOP's scheme would have prevented the Civil Aeronautics Board and the ICC from starting the administrative deregulation that made the airline and trucking deregulation bills possible. Under the GOP's approach, agency lawyers would be strengthened and economists weakened. Caution would win out over creativity. Reform from within the agencies would grind to a halt.

**Under the GOP's approach.... [c]aution would win out over creativity. Reform from within the agencies would grind to a halt.**

Some work still has to be done in generic procedural reform, but the biggest payoff in the coming years will come from continuing the slow tough job of substantive reform—program by program and statute by statute. The lesson of the past four years is that success requires picking priority targets and then coordinating appointments, administrative action, and legislation.

The Republicans do call for this kind of reform, but their platformese is naturally ambivalent about exactly what they would do. Typical planks include:

- *Environment:* This will be a critical area no matter who wins the election because major air and water laws will soon be up for reauthorization. The Republicans support "a healthy environment," but want reforms "to ensure that the benefits achieved justify the costs imposed." They do not say how to do this. They also want responsibilities returned to the states, and they want speedier decisions on permits. They either do not say or do not know that most of the delays are at the state and local level and that the proposed Energy Mobilization Board—which many of their members of Congress helped to defeat—was aimed at this problem.
- *Transportation:* The platform contains a paean to the "freedom exemplified by the automobile." The Republicans would cut "safety and environmental standards" (unspecified) and eliminate the 55 mph national speed limit. They also call for steps to increase automobile and driver safety but fail to indicate how this can be done without regulation. (The platform is rife with calls for tax incentives; maybe it contemplates a special tax deduction for "safe drivers"!)
- *Food and Drugs:* The Republicans attack "FDA's excessive reliance on 'zero risk' policies" and call for statutory reform. The Carter administration has sought legislation to speed both certification of new drugs and removal of dangerous old ones, and another try is needed. It may also be desirable to increase consideration of costs and risks.
- *Education:* The Republicans would abolish the new Department of Education, halt the IRS "vendetta" against independent schools (a somewhat loaded description of the effort to discourage segregation), and—above all—replace categorical aid programs with revenue block grants. They are right that the proliferation of categorical grant programs in education—and in health, welfare, housing, and other areas—imposes excessive rules and paperwork on state and local governments. But they also endorse goals like civil rights enforcement and special training for the handicapped and disadvantaged, while saying nothing about how to achieve these goals without controls on the ways in which the federal money is spent.

THE REPUBLICAN PLATFORM betrays an underlying dilemma. The Democrats' regulatory reform program is already chalking up solid gains in making rules more flexible and less costly without sacrificing goals. The Republicans claim to agree with the goals, but they so dislike and distrust regulation that they will not use it to achieve them. In fact, their "war on overregulation" carries almost as much freight as tax cuts in their promise of an instant cure for the economy. Instead of using the White House to manage the regulatory process, they look to the other branches of government to bury it. That way, they can walk away from their dilemma. Their approach can increase delay and uncertainty, slow reform, and cripple regulation as a basic instrument of government—an instrument that allows our fragmented institutions to get necessary work done.

With luck, we will not have to find out whether the Republicans mean it. ■



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# COMPENSATING VICTIMS

Robert S. Goldfarb

COMPENSATING THE "VICTIMS" of government policy changes for job or wage loss has gathered quite a head of steam in recent years. (I say victims because, whatever one's approach, and whether one wants to do something or nothing about it, some workers are in fact hurt by fundamental changes in government policy—by deregulation in particular—and the hurt is most commonly reflected in loss of jobs or wages.) The trade adjustment assistance program of 1962–1975, for example, compensated workers injured by lowered trade barriers. Other examples include labor protection provisions in CAB-approved airline mergers and comparable provisions for transit workers affected by urban mass transit grants, railroad workers hurt by the formation of Amtrak and Conrail, airline workers displaced by the 1978 Airline Deregulation Act, and loggers whose trees were absorbed into the Redwood National Park, also in 1978.

The growth in compensation programs has not been matched, however, by much systematic analysis of either rationales for or actual experience with such programs. How do they work? Do they in fact "work" at all? Do they fulfill the various promises held out for them? Here we seek some of the answers.

Professor Gordon Tullock of VPI argued in these pages two years ago that a policy of compensating the victims of government actions might have at least three advantages (see *Regulation*, November/December 1978). On the level of pure pragmatics, he suggested, compensation may lead to "political buy outs." That is, it may help secure passage of desirable legislation, such as regulatory reform, by disarming the opposition. Moreover, a compensation policy may be appealing on equity grounds, in that the "deserving" victims of government policy changes are helped to adjust. And a compensation policy may even promote increased efficiency in policy formulation by government agencies. If they are required to pay compensation, their estimates of costs and benefits may be more realistic—may even result in sounder policy choices. As far back as 1974, Harold Hochman of City University of New York provided a more elaborate equity rationale (see *Redistribution through Public Choice*, H. Hochman and G. Peterson, editors). He argued that fundamental considerations of fairness might *require* compensation. Dealing equitably with those who suffer windfall losses because of changes in rules or institutions, he suggested, may be a necessary precondition for preserving belief in the system's essential fairness. At the very least it may create a perception that the process of changing the rules is equitable.

Even at this early stage in the analysis, some reflections are in order (and here I draw heavily on work I have done in collaboration with my colleague Joseph Cordes). First and most obviously, policy choices about compensation rely on fundamental and varied value judgments. Hochman's fairness view has very

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# )F POLICY CHANGE

*"Harebrain hypothesis, lousy documentation, meddlesome rules—you've got the makings of a great federal program, here, Winslow!"*

different ethical premises than the political buy-out view, and both differ in turn from the position some have taken that compensation is *un*ethical and *un*fair if it provides reimbursement for the loss of "ill-gotten monopoly gains." Then, too, different views of compensation imply different levels of payment and even different recipients. The fairness view would seem to involve paying full or nearly full restitution to all those hurt by a government rules change, while the political buy-out view would lead to paying the minimum amounts to the fewest possible victims consistent with achieving the desired legislative result. All of which suggests that any notion that a compensation policy can readily achieve several desiderata at once—ranging from political buy outs to promoting fairness and better policy choices—may be wildly misleading. Or naive. Or a delusion. Or all of the above.

As if the theoretical underpinnings did not create enough problems, the implementation of compensation policy raises many more.

- The first is the difficulty of clearly delineating legitimate from illegitimate compensation situations. Does paying compensation in a specific case necessarily open a Pandora's box that leads inexorably to widespread and overwhelmingly expensive additional programs?
- A second problem arises from the claim that compensation programs enhance perceptions of the system's equity or fairness. Yet actual program experience suggests that this claim may be seriously wide of the mark.
- And, in the third place, a number of issues arise concerning the precise design of particular compensation schemes. These design issues play a large part in determining the efficiency and equity of any one scheme—and can strongly color one's views of the efficacy of compensation in general. Thus a legislator might believe that compensation is in principle a good idea but that design problems make any actual scheme so imperfect, so fraught with difficulties, as to be unworkable: what is de-



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sirable in principle must therefore be abandoned in practice. Design problems include determination of the "boundaries" of payments (how far out do the waves of impact extend?), their incentive effects on job seeking or remaining unemployed, and the devising of target-efficient mechanisms for triggering compensation programs in the first place. (There is also, to be sure, a more positive aspect to these problems of design. For example, compensation can be paid by different mechanisms, some explicit —that is, actual payments—and some implicit —that is, limited postponement of a policy change. While this is itself a design "problem," it suggests that judicious choice of design may minimize other difficulties.) We will return to all of these problems in due course.

**Opening Pandora's Box**

The very act of paying compensation for job losses when it seems clearly justified might create political pressures to pay compensation when it is not so clearly justified (or not justified at all). Such a domino effect is certainly no stranger to public policy. In tax law, for example, percentage depletion for mineral A led to pressures for percentage depletions for minerals B through ZZ. Attempts to provide fair treatment of single persons by altering tax rates led to the claim (with some truth) that married persons were unfairly treated. While chain reactions always are a real danger, there may be ways of controlling them. Some of the rationales for compensation cover only the very limited set of job losses resulting from fundamental rules changes. Thus, insofar as actual compensation programs are proposed, defended, and passed with unequivocal reference to a limited-scope compensation rationale of wide appeal, this may provide a bulwark against attempts to widen the population of potential claimants.

**The very act of paying compensation for job losses when it seems clearly justified might create political pressures to pay compensation when it is not so clearly justified (or not justified at all).**

Consider how Hochman's fairness rationale might work to limit compensation claims. This rationale seems to endorse compensation for those harmed by government rules changes but generally not for those harmed by a range of other public actions, or by private market shifts. What then is "fair" when jobs are lost in an industry where they are known to be typically short-lived? A well-informed worker choosing between such a job and one that probably would last longer in another industry might well accept the short-lived job only at a large enough wage differential. In other words, those losing the "typically short-lived" jobs *already* have been compensated by higher wages—so that additional public compensation is inequitable as well as unwarranted! This no-compensation argument holds not only for pure private-sector job losses but also for those at defense contractors and for similar government-financed employment. It is surely true in defense industries that relative instability of employment is well-compensated by higher wages.

On the other hand—do not count on the power of an explicit rationale to limit compensation. Pressure groups are many and varied, and their claims are legion. As Robert Harris, executive vice-president of the Urban Institute, has emphasized,

> all sorts of groups will seek to develop claims on public funds using the argument that they have been hurt by public action, whether or not they have been so harmed. And some of the groups may be politically irresistible. . . . When public compensation for government-caused harm is accepted as an intellectually respectable basis for public expenditures, it can be used to cover almost anything.

Harris cites the black lung program as one example, and a very expensive one. Whereas its supposed rationale was to help coal miners whose lungs had been damaged by working in the mines, the program in fact benefits many individuals who have never suffered such damage. "At the time the program was enacted in its current form," Harris explains, "it was known by most involved actors that the program would 'overcompensate'—but it was politically irresistible." A second example involves veterans programs, which, according to Harris, compensate many people with no service-



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related injury. While these examples do not directly concern job-loss compensation, the general problem is clearly parallel.

It is an open question, then, whether *any* rationale, however explicit, however well-reasoned, is likely to provide an effective bulwark against the spread of compensation programs to arguably inappropriate situations. A skeptic might well point out, for example, that trade adjustment assistance (TAA), which started out as a program for compensating workers hurt by lowered trade barriers, was expanded in the Trade Act of 1974 to cover workers whose job losses were not related to such changes. The skeptic might also note that if Chrysler were finally to shut down, intellectual rationales for not paying compensation in such a case—where the public already has made a substantial investment—would likely give way to strong political demands for still more aid. Of course, in the absence of a well-reasoned rationale of wide appeal, such a cancerous spread would be even more of a danger.

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### Equity in Action

We have noted that a major argument for compensation programs is that such payments make the system seem fairer and more equitable. But actual program experience suggests that paying compensation need *not* promote perceptions that the system is fair—may in fact produce exactly the opposite effect. Indeed, the connection between fairness and compensation may be tenuous at best.

Consider, for example, the compensation program for loggers adversely affected by the expansion of the Redwood National Park. In only the first eight months of the program, weekly benefits (of about $3.4 million) plus severance payments (of almost $4 million) averaged some $6,300 for each of 1,156 workers. And compensation per worker of this dimension outraged many observers. A CBS Evening News report on March 15, 1979, opened with a description of a former logger who was being paid $30.40 an hour "for doing absolutely nothing." The general tone of the report was that the program encouraged able-bodied workers not to work and generally smacked of a rip-off. Moreover, it was noted that claims of fraud were being investigated. Clearly, outside observers were not given the impression that this compensation program made the system more fair.

A second example is the trade adjustment assistance program of 1962–75, which was supposed to provide severance pay to those losing their jobs because of lowered trade barriers. For fully seven years, no TAA payments were authorized at all, and relatively few were authorized for several years thereafter. The Tariff Commission (now the International Trade Commission), which had to approve payment applications, used a case-by-case approach and very stringent criteria for determining eligibility—hewing more to statutory than to economic judgments. Labor groups, which had probably fought less strenuously for continued trade restrictions because of the presumed availability of TAA payments, were infuriated by this failure to approve compensation in what seemed to be highly justifiable circumstances. This compensation scheme certainly did not promote the view among organized labor that the system was fair. Interestingly, while both the Redwood and TAA cases illustrate the danger of any easy assumption that compensation promotes perceptions of fairness, the sources of disillusionment are polar opposites. In the Redwood case, the problem was that individual payments were too generous; in the TAA case, disillusionment stemmed from the fact that too few cases were compensated. Apparently, promoting a perception of fairness requires following a very narrow "flight path"; raising *or* lowering the "altitude" is likely to result in disaster.

There are several implications to be drawn from these experiences. Both cases show the sensitivity of perceptions of fairness to specific design features of the compensation schemes. In the pre-1975 TAA program, the trigger mechanism for getting compensation started was



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case-by-case examination by a commission—as it happened, by one that used statutory criteria interpreted in such a way that cases of economic merit were denied. Moreover, the case-by-case trigger, as would be expected, resulted in long delays and thus in a failure to provide transitional income support when it was most needed.

In the Redwood case, incentives built into the program tended strongly to promote continued unemployment even when attractive job opportunities were available. (While any severance pay program is likely to have some unemployment-increasing incentives, we will have occasion to note that they can be lessened by careful design.) Then, too, the size of the payments seems outlandishly large. The fact that they were so large may simply have reflected shrewd political maneuvering by the labor organizations involved, but a more subtle explanation is possible. The loggers received payments based on past wages, and those past wages doubtless reflected a substantial premium for the fact that logging is a dangerous business. But when someone is paid *not* to log, the payment necessary to restore real income should be smaller than the prior wage by at least the "danger premium": no more danger should equal no more premium. This suggests that, for dangerous or otherwise unpleasant occupations, the uncritical use of prior wages as the basis for payment results in *over*compensation.

A second implication about the ability of compensation payments to promote fairness goes back, of course, to fundamental views of what is fair. There are those who do not find any equity rationales convincing—on the grounds, for example, that risk is inherent in the market system, that the system depends on encouraging individuals to adjust to change, and that any compensation scheme slows down such "natural" adjustment. To such individuals, compensation programs are fundamentally undesirable—and fairness has nothing really to do with it.

Finally, there is the view—politically highly realistic—that compensation programs are most likely to be established when the victims have political clout. It is no accident, from this perspective, that union members are often in the group to be compensated. This "selective incidence of compensation programs" is itself likely to be viewed as unfair by many observers, the more so because political clout tends to correlate with wealth and not necessarily with "deserving victims." In short, the argument that compensation automatically promotes increased belief in the system's fairness is much too naive.

## Design Problems

These are the problems that arise in trying to implement compensation programs in a manner consistent with chosen rationales, and with such other desiderata as minimizing transaction costs. In this sense, the failure of compensation programs to promote perceptions of fairness is just one example of a (particularly important) design problem. Three kinds of design problems are of particular interest—those involving trigger mechanisms, incentives for working or staying unemployed, and delineating a program's boundaries.

**Trigger Mechanisms.** Triggers are the devices that start compensation payments flowing. The TAA program was set up, as noted, with a case-by-case or discretionary trigger. The Airline Deregulation Act, on the other hand, provides that a 7½ percent decline in employment in a twelve-month period at any qualifying airline in existence prior to deregulation constitutes presumptive evidence that a compensation program should be "triggered on." While the legislation is ambiguous on whether the 7½ percent decline is sufficient by itself (without additional action by the CAB) to start compensation, our assumption will be that it is. So we have in these two programs the two extremes of trigger mechanisms.

One important criterion for any compensation scheme is promotion of "target efficiency"—that is, compensation should be paid to *all* deserving recipients and *only* to deserving recipients. Clearly, a deregulation compensation program that provides payments to many who are not hurt by deregulation while failing to compensate many who are hurt will be both cost-ineffective and unfair.

How then are deserving recipients to be identified? One technique is simply to pay compensation to everyone losing a job in the deregulated industry after deregulation. Period.



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This technique has the advantage of minimizing the real cost of deciding who should receive compensation. But it would almost inevitably result in considerable target inefficiency: some of those being compensated would surely have lost their jobs anyway, deregulation or not. The case-by-case technique "solves" this difficulty. But again there is a flip side. Even apart from the decision-making expense involved in examining each case in detail and apart from the inevitable lags in payments to deserving recipients, there is, as the old TAA program indicates, the fundamental issue of the criteria on which decisions are based. If these criteria are not at least partially prespecified, a compensation program may function in a legislatively unintended, or even random, way. Indeed, the TAA process never impressed analysts with its subtle logical consistency. If all the criteria *are* effectively prespecified, on the other hand, case-by-case determination becomes all but an automatic trigger.

But then automatic triggers also have their difficulties. Some rule, some jumping off point must be chosen, and it is likely to be arbitrary to a degree. Even if a very elaborate rule were to be designed by a panel of economic savants, it would still exhibit some arbitrary features and produce some target inefficiency. This must be true because of the virtual impossibility of sorting out all job-losing individuals into the two categories of "caused by deregulation" and "for all other reasons." Moreover, actual trigger rules are unlikely to be elaborate structures designed by economic savants. Instead, they will usually be rules of thumb concocted by legislatures through political give and take. The trigger specified in the Airline Deregulation Act is a 7½ percent decrease in employment at a qualifying airline. But surely a decrease of that size is more likely in a recession than in the beginnings of a boom. So even if 7½ percent is right, on average, it is going to be too generous in a recession and too stringent in a boom. And why pick 7½ percent anyway? The original Senate bill proposed 15 percent, a number defended in a Senate report with the argument that 15 percent is large enough to subsume all "normal" cyclical patterns, which of course indicates the danger in terms of target efficiency of the 7½ percent rule. Indeed, the most intellectually palatable rule would give *different* percentages depending on the level of aggregate economic activity, relative input price changes, and other important factors. It is unlikely, however, that legislated compensation programs would ever mandate rules of such elegance.

**Even if a very elaborate rule were to be designed by a panel of economic savants, it would still exhibit some arbitrary features and produce some target inefficiency.**

These triggering difficulties do not, of course, "prove" that compensation programs must be dismissed out of hand; any such conclusion requires careful consideration of a number of complex program benefits and costs —and our analysis has not yet run its course. We stress these difficulties for three reasons: (1) to sharpen our sense of the complexity of projecting the anticipated benefits and costs of compensation programs; (2) to indicate yet again the sensitivity of program attractiveness, as well as workability, to design features; and (3) to provide a potent illustration that alternative *forms* of compensation are differentially subject to such specific difficulties as target inefficiencies induced by the particular trigger that is chosen.

Our discussion of trigger mechanisms focused on one type of an *explicit* compensation program—one that involves severance pay. An alternative *implicit* form of compensation would involve postponement. If a reform is announced today, to take effect in $N$ years, this $N$-year postponement provides implicit compensation to those who will be hurt by the reform. It does this by delaying the cost impact of the reform and therefore making it smaller in the present value sense. And because no explicit compensation is involved, no trigger mechanism is required. Moreover, the target-efficiency problem does not really arise *because all of those hurt by deregulation are automatically compensated!* Postponement *automatically* achieves a very high target-efficiency score. It helps only those who would have been hurt and does so "automatically" by delaying the hurt. So far, on the basis of the target-efficiency criterion at least, postponement of change looks like a good bet.



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**Minimizing Unemployment Effects.** There is reasonably good empirical evidence that unemployment compensation generally increases the duration of unemployment. Because severance pay programs are similar to, but longer-lasting and even more generous than, ordinary unemployment compensation, their unemployment-increasing effects are likely to be greater. Rather than encouraging the displaced worker to find another job as fast as possible, the availability of severance pay may slow down this process, thereby raising the real social cost of the policy change that provoked the displacement. Moreover, as the Redwood example shows, the appearance of "induced idleness" can outrage observers and counteract whatever equity advantages a compensation program might embody.

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For any specific compensation scheme, attention will naturally focus on how large the unemployment effects are likely to be. Is it possible, through judicious program design, to hold down the unemployment-increasing incentives of compensation? Aside from the obvious point that the generosity of compensation will almost certainly affect the scale of induced unemployment, a number of other considerations enter into the equation. First of all, a severance pay scheme that does not condition payments on unemployment status is likely to have fewer unemployment-inducing effects than a system that is unemployment-conditioned. Consider, for example, a severance pay scheme that provides fixed monthly payments for a predetermined number of months, whether or not a new job is obtained; then compare this scheme with one that provides payments *only as long as the potential recipient is unemployed.* Suppose further that the anticipated total payment per recipient is the same under both schemes. The predetermined payments scheme is almost certain to promote a quicker return to work, because returning to work does not involve a loss of severance pay.

Chalk up one (it would appear) for predetermined payments schemes. Unfortunately, however, design issues are rarely as clear-cut as they appear. In this case, the predetermined payments scheme has the important *dis*advantage that "excess" payments go to individuals who find jobs right away and have no need for transitional support, whereas those who fail to find jobs by the time the payment period ends will not receive anything extra. In short, gains associated with better incentive features are offset by losses in target efficiency and equity. This kind of a trade-off is typical of the dilemmas besetting compensation policy.

Another point to be made about unemployment effects involves a comparison of a straight severance pay scheme with one that makes payments during unemployment *and also* makes up a portion of wage losses for some period after reemployment. Under the latter, if wages on the new job are less than the wages on the job from which the individual was displaced, a percentage of the shortfall is reimbursed. A wage reimbursement scheme should induce less unemployment than a straight severance pay scheme, because wage reimbursement lowers the cost—in terms of lost severance payments—of taking a job. The compensation scheme in the Airline Deregulation Act, for example, contains wage reimbursement features.

Or, again, compare the unemployment-inducing effects of severance pay with implicit postponement compensation. Suppose, for example, that compensation in the Redwood case had been "paid" not immediately—by implementing the policy change and therefore providing severance pay—but rather by postponing expansion of the park. By switching to compensation through postponement, the unemployment-inducing feature of severance pay is of course eliminated—simply because there is no severance pay. Moreover, by postponing the change, workers are given time (and an incentive) to look for other work *before* their jobs disappear. To the extent that workers believe the change will not be postponed indefinitely, this recourse may promote a less socially costly pattern of reemployment.

This example illustrates the attractiveness of postponement, but also suggests why post-



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ponement is no panacea. In the Redwood case, it might have resulted in an orgy of redwood cutting as logging companies tried to reap as many benefits as possible before the (postponed) date of the federal takeover. This, clearly, would have been a most undesirable outcome.

Finally, concern about unemployment effects has sometimes provoked unusual program design features aimed at least in part at minimizing these effects—features that themselves may create bizarre and certainly unintended outcomes. A prime example is the requirement in the Airline Deregulation Act that job openings be offered first to applicants laid off by other airlines. According to the Labor Department's proposed implementing regulation, this requirement applies even if an individual with sufficient seniority loses his job for reasons other than deregulation. While there is some question about the enforceability of the regulation, if enforced it might result (as the *Wall Street Journal* has claimed) in putting "the Labor Department in the position of running what industry and union leaders say amounts to a 'national hiring hall' in the airline industry" (December 7, 1979). The implications and possible precedents are mind-boggling.

**Determining Payment Boundaries.** When an industry is deregulated—say, the airlines—and a long-established firm in that industry goes bankrupt, an argument can be made for compensating the affected personnel. But suppose airline deregulation leads to a big increase in airline business and, as an indirect result, several intercity bus lines go bankrupt. Do the displaced bus drivers not have a similar claim to compensation? They too are victims of airline deregulation, after all. And if bus drivers are compensated, how about workers laid off from the firms that produce buses? And so on, more or less to infinity. Conceptually, how far removed does the injury have to be before it need *not* be compensated? While one can legitimately argue for narrow compensation boundaries because of measurement difficulties—it would, for example, be virtually impossible accurately to attribute job losses in bus employment to airline deregulation versus all other causes—this argument does not eliminate the *logical* inconsistency involved, and therefore does not resolve the equity issue. In point of fact, the Airline Deregulation Act does limit compensation to airline employees only.

If the airline-bus example seems a bit far-fetched, a case involving trade adjustment assistance may be more compelling. Suppose that piano imports rise because of a change in trade policy, and domestic production of pianos falls as a result. Then workers in domestic piano-producing firms should qualify for TAA. But it is quite plausible that, as domestic production of pianos falls, domestic production of specialized inputs to pianos ("piano parts") is also likely to fall—without any increase in imports of piano parts. Should displaced piano-parts workers qualify for TAA? And what about workers who produce special wires that are then sold exclusively to the piano-parts producers? In the actual case, the Tariff Commission ruled that piano-parts workers did not qualify for TAA, apparently because there was no associated rise in piano-part imports. This decision, which makes little *economic* sense, was no doubt based on strict statutory construction. The larger point, however, is that there is a serious measurement and conceptual equity problem in deciding how far afield to go.

As with trigger mechanisms and unemployment effects, so also with delineating boundaries: severance pay compensation raises boundary problems, while postponement compensation does not. Because postponement delays all bad effects automatically, it automatically delays them for bus drivers as well as airline workers, for piano-parts workers as well as piano producers. From the perspective of the boundary problem at least, postponement looks extremely attractive.

## Is Postponement the Answer?

As answers to compensation dilemmas go, a postponement strategy does indeed look good. But it raises difficulties uniquely its own. Consider, for example, whether recipients of postponement compensation are likely to consider themselves compensated, and therefore fairly treated, to the same degree as if they had received severance pay. While an economist can appreciate the argument that postponement today provides compensation (reduced present



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value of loss) today, the typical recipient of postponement compensation might well find this subtlety cold comfort on the future day when his job really does disappear. Another serious problem with postponement is the lack of inevitability of the policy change. If there are compelling arguments and strong political pressures for postponing a deregulation today, is it not likely that the same arguments and pressures will reappear at the future date (now postponed) of the policy change? Indeed, opponents of deregulation or tariff reductions may be more than happy to defuse pressures for change by accepting postponement, knowing they can refight the fundamental decision as the new effective date approaches. Legislation to decontrol fuel prices "later" provides a useful example of the difficulties involved. And even if all these matters are set aside, it still is necessary to weigh costs and benefits. A major cost of postponement is the benefits lost precisely *because* the policy change is delayed. In particular cases, these costs may be very large, and they must in any case be calculated and compared to the costs of compensation.

First cousin to compensation-by-postponement is what might be called the "keep it vague" strategy. Clearly, different interests and therefore different legislators might and do support compensation legislation for very different and often conflicting reasons. Thus, in order to form the broadest possible coalition of support, the legislation is often left sufficiently vague that groups which favor compensation for quite different reasons can come together. This is precisely what happened with the Airline Deregulation Act. Such a crucial feature as the percentage of prior wages on which severance pay was to be based was not specified in the legislation—instead, it was left to be determined by the secretary of labor after the fact—so that groups wanting high compensation and groups wanting low compensation could all vote "yea." In fact, the proposed federal regulations were written with a rather tight cap on the monthly payments, and this must have given the pilots union an unpleasant shock: the cap provides a relatively low level of compensation to any senior pilot who gets displaced.

And legislative indeterminacy itself creates a dilemma for the advocates of compensation policy. Getting a preliminary agreement that compensation will be written into legislation is a first step only. It does not guarantee that the actual compensation features that result will fit any particular pattern. Advocates of compensation must face the awkward fact that, when they lobby or vote for compensation provisions, they really are buying a lottery ticket on which they and their compensation principles could just as easily end up losers as winners.

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**Whatever one's grand philosophical rationale for compensation, it is very difficult (probably impossible) to produce an actual scheme that is not seriously flawed—that may even contradict and negate the rationale itself. . . .**

**All of our experience with the concept of compensation counsels the high probability that any specific compensation scheme will be ridden with seemingly intractable dilemmas. . . .**

The moral of this long, somewhat unhappy tale can be succinctly stated. Whatever one's grand philosophical rationale for compensation, it is very difficult (probably impossible) to produce an actual scheme that is not seriously flawed—that may even contradict and negate the rationale itself. These flaws can arise from the inherent difficulty of program design, the need to form political coalitions, the very existence of differing philosophical views about compensation, or (as Robert Harris stresses) the political irresistibility of giving something to most everyone. All of our experience with the concept of compensation counsels the high probability that any specific compensation scheme will be ridden with seemingly intractable dilemmas. A hard lesson, indeed, about hard reality—but harder still if we refuse to learn it. ■



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# Protecting Workers' Hearing: An Economic Test for OSHA Initiatives

James C. Miller III  Thomas F. Walton

THE CRESCENDO of criticism directed toward U.S. health, safety, and environmental regulators has given new impetus to the economist's tool of benefit-cost analysis as a means of improving agency performance. Since 1974, all executive-branch agencies have been required, by presidential executive order, to estimate the benefits and costs of their major regulatory proposals. Pending legislation would codify this requirement and extend it to the independent agencies. In its present and prospective forms, however, the requirement is not subject to judicial review, and thus leaves a considerable amount of room for agency discretion.

On the other hand, a few enabling statutes actually require agencies to analyze benefits and costs and to give the results some weight in their decisions. For example, the Supreme Court, in *Industrial Union Department, AFL-CIO* v. *American Petroleum Institute et al.*, recently concluded that the Occupational Safety and Health Administration (OSHA) must establish that its proposed standards for carcinogens would generate substantial benefits. Whether OSHA must also demonstrate that such benefits would be reasonably related to costs—as held by the Fifth Circuit Court of Appeals—is a question on which the Supreme Court did not rule.

Throughout the debate on the utility of benefit-cost analysis, there has been wide-

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spread skepticism over whether the technique is generally applicable and whether imposing such a requirement as a matter of law would not result in excessive and unproductive litigation. In partial answer to these concerns, we describe here a relatively narrow regulatory issue, but one where judicial interpretations have moved in the direction of requiring that the benefits and costs of a proposal be reasonably related and where benefit-cost analysis may be applied in a fairly routine way.

The issue we address is occupational noise. OSHA has determined that workers exposed to certain levels of noise on the job run a significant risk of permanent hearing impairment. The agency's present Noise Exposure Standard limits the noise level in a work place to 90 decibels (dBA) over an eight-hour day, or higher levels for shorter periods.* When the standard is exceeded, employers are required to adopt administrative or engineering controls to reduce the noise. This usually involves the close monitoring of sound levels and the redesign or alteration of equipment (for example, by placing machines further apart and by constructing sound-reducing enclosures around an entire machine or its especially noisy components).

According to OSHA, it is only when those kinds of controls are not "feasible" that the alternative of personal protection equipment —earplugs or earmuffs—may be considered. Moreover, such controls must be employed to the extent "feasible," even if they cannot reduce noise enough to meet OSHA's noise standard (in which case personal protection equipment must also be worn). Thus, the question of "feasibility" has great importance with respect to both the costs of complying with OSHA's standard and the benefits derived.

Neither OSHA nor the courts interpret the term "feasible" in the strictest sense of being possible at less than infinite cost. OSHA's interpretation concedes that administrative and engineering controls are not feasible if their costs would result in shutting down an industry or a substantial part of it, with a consequent loss of jobs. The courts, however, have increasingly gone beyond this, finding "feasible" to mean that the benefits that would result from an OSHA standard must be "reasonably" related to the costs. Consequently, there has emerged a two-part test of feasibility—technical feasibility (would the controls in fact reduce the noise?) and economic feasibility (would the benefits associated with the controls be reasonably related to the costs?).

Our purpose here is to show how the benefits and costs of an OSHA noise-abatement program can be analyzed, and how such economic analysis can provide an appropriate framework for judging the question of economic feasibility. In order to illuminate the development of the economic feasibility test and to give the reader some sense of the institutional setting in which disputes on these issues are resolved, we first review the pivotal legal decisions that have shaped the benefit-cost relationship of OSHA's initiatives for reducing industrial noise. Then we undertake a benefit-cost analysis of OSHA's proposal for reducing noise in a particular General Motors (GM) plant. While this case is not necessarily representative of all of OSHA's initiatives in this field, it illustrates the importance for all concerned—employers, employees, regulators, and the public—of sorting through the ramifications of a proposed regulatory scheme with utmost care.

## The Case Law on Occupational Noise

If an OSHA official cites a firm for violating one of the agency's standards, the firm has the right to demand that the agency explain what measures could be taken to correct the problem. The firm may then either acquiesce in OSHA's plan (or an OSHA-approved substitute), or challenge the plan before the tribunal established to hear such complaints—the Occupational Safety and Health Review Commission. If either party (OSHA or the firm) is displeased with the commission's decision, it may appeal to the federal courts. Thus, decisions by the Review Commission and the courts form the case law on occupational noise.

**Review Commission Decisions.** The first relevant case to come before the Occupational

* 29 CFR 1910. The standard limits the average sound level to 90 dBA for eight hours, 92 dBA for six hours, 95 dBA for four hours, 97 dBA for three hours, 100 dBA for two hours, 102 dBA for 1.5 hours, 105 dBA for 1.0 hours, 110 dBA for 0.5 hours, and 115 dBA for 0.25 hours or less.



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Safety and Health Review Commission was *Love Box Company* (April 7, 1975). Here the commission concluded that OSHA's proposal to force a manufacturer of corrugated boxes to employ administrative controls was infeasible because it would have adverse effects on productivity. The commission stopped short of trying to quantify the benefits and costs of OSHA's proposed remedy, but it did find that they were relevant to the feasibility of that remedy.

Almost a year later, in *Reynolds Metals Co.* (February 25, 1976), the Review Commission rejected as infeasible OSHA's recommendation for a Reynolds Metals plant producing tin cans. Principally at issue was the agency's lack of knowledge concerning the ramifications of its proposed remedy. The commission held that for a plan to be deemed feasible, OSHA must demonstrate that the remedy would in fact be effective in reducing the level of noise. The commission also noted testimony by Reynolds' operations manager that some of the proposed noise-suppressing techniques might reduce productivity and perhaps cause other problems such as a build-up of fumes. This suggests the commission's concern with both benefits and costs.

Of all the decisions on industrial noise handed down by the Review Commission, the most important to date has been *Continental Can* (August 24, 1976). The principal facts in the case were as follows. For a development cost of $1.23 million, an installation cost of some $32 million, and an annual maintenance cost of $175,000, the company could have designed, installed, and maintained enclosures that generally would have reduced the level of noise to 90 dBA. This was OSHA's proposal. Continental responded that it already had in place a hearing protection program that cost only $100,000 a year and was generally viewed as effective. The Review Commission ruled in Continental Can's favor. It concluded that OSHA's noise standard, under which the proceeding had been brought, "only requires the implementation of those engineering controls which are economically, as well as technically feasible." It further stated: "In determining whether controls are economically feasible, all the relevant cost and benefit factors must be weighed." Observing that "[c]learly employers have finite resources available for use to abate health hazards," the commission went on to note that these resources should be allocated to the highest priorities first—namely, hazards that are life-threatening.

Thus, in *Continental Can* the Review Commission established the relevance of benefit-cost analysis to judgments concerning the lawfulness of OSHA's compliance measures. Moreover, it enumerated the types of benefits and costs to be considered. But it was not able to provide a precise estimate of the costs per employee affected.

However, using data from the commission's decision for three of Continental Can's twenty-nine plants, we can provide a rough figure. In those three plants, OSHA's plan would have achieved the noise standard for about 125 employees. The estimated one-time costs of developing and installing the engineering controls were $132,000 and $362,000 respectively, the annual maintenance costs were $2,500, and the annual savings from eliminating the existing program of personal protection were $650. Subtracting savings of $650 from annual maintenance costs of $2,500 yields *net* annual operating costs of $1,850. Dividing total development and installation costs of $494,000 by 10 (for a 10 percent discount rate) yields an annual equivalent of $49,400. Adding to that figure net operating costs of $1,850 and dividing by 125 workers yields an estimated cost of $410 per employee per year. In other words,

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Thus, in just a year and a half, the Review Commission's concern for the efficacy and possible adverse effects of an OSHA proposal (*Love Box*) evolved into a requirement that OSHA



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give evidence that its proposed remedy would be effective and perhaps would not have significant adverse consequences (*Reynolds Metals*), which, in turn, became a requirement that OSHA demonstrate a reasonable relationship between the benefits and costs of its proposal (*Continental Can*).

Thereafter, following the guidelines laid down in *Continental Can*, the Review Commission concluded in several other cases that the costs of the proposed remedy outweighed the potential benefits. For example, in *West Point Pepperell, Inc.* (April 18, 1977; upheld by the appeals court in February 1979), the commission found economically infeasible an OSHA proposal having a first-year cost of about $5.4 million (which implies an annualized cost of $540,000) and a subsequent annual cost of $2.6 million—for a total yearly cost of over $3.1 million. With only 380 employees affected, the annual cost per employee was some $8,300—a figure far higher than the $410 in the case of *Continental Can.* Similarly, in *Castle & Cook Foods* (May 19, 1977), the commission concluded that the annual costs of an OSHA-proposed remedy (ranging from $451 to $1,410 per protected worker) were excessive in comparison with the benefits. One reason for this finding, the commission said (as it had in *Continental Can*), was that resources to reduce employee safety and health hazards are limited and should first go toward solving more hazardous (life-threatening) problems.

It should be noted that in this case the commission concluded that, without the proposed engineering controls, there would be a greater risk of hearing loss. Nevertheless, it ruled that this risk was not enough to justify the estimated cost. A year later, in *Great Falls Tribune Co.* (May 19, 1977), the Review Commission found that OSHA's proposed program of engineering controls was technologically feasible, but that it would not reduce noise to the agency's standard. Consequently, employees would still be required to wear personal protection equipment (earmuffs in this case). With few benefits identified and total costs amounting to $1,250 per employee per year, the proposed program of controls was found to be economically infeasible.

However, in *Louisiana Pacific Corporation* (October 19, 1977), the Review Commission concluded that engineering controls are economically feasible where the cost per employee is modest and the noise reduction substantial. Evidence in the proceeding suggested that personal protection equipment was less effective than the proposed engineering controls, which would reduce the company's noise to meet OSHA's standard for an annual cost per employee of $300 to $500. The commission came to a very similar conclusion in *Carnation Company* (June 20, 1978), now on appeal. In that case the noise reduction was also substantial, while the annual cost per employee ranged from $200 to $1,000.

In *Samson Paper Bag* (June 13, 1980), the Review Commission unanimously remanded the dispute to the administrative law judge for a new trial based on the benefit-cost test of *Continental Can.* Even though two of the three Review Commission judges expressed dissatisfaction with certain aspects of the *Continental Can* precedent, they could not agree on a superior test of economic feasibility. As a result, both judges concurred that, for now, the *Continental Can* decision is "dispositive" on that issue.

**Court Decisions.** The first major noise-abatement case to be appealed from the Review Commission to the federal courts was *Turner Company* (August 31, 1977). Here the Seventh Circuit Court of Appeals, in setting aside the commission's decision, concluded that an annual cost per employee amounting to $333 was too high in comparison with the benefits that might have resulted from using engineering controls instead of personal protection equipment.

A year later, in *Continental Can* v. *Secretary of Labor, Marshall* (August 8, 1978), Continental won its appeal to the U.S. District Court for Southern Illinois to enjoin OSHA from citing any of the company's plants not specifically covered in the Review Commission's *Continental Can* decision. The district court said that *Turner* "clearly upholds the requirement of economic feasibility, on a comparison basis with personal protective alternatives. . . ." It also emphasized that the capital outlay involved in the *Turner* decision amounted to "only $30,000 in the single plant involved"—that is, $333 per employee per year. Interestingly, the court expressed a concern that an OSHA mandate for engineering controls



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might actually increase employee noise exposure in Continental Can's plants, since a noise reduction to meet OSHA's standard could bring about a situation in which the far more effective personal protection equipment would not be worn.

Finally, in *RMI Company* v. *Secretary of Labor et al.* (March 13, 1979), the Sixth Circuit Court of Appeals rejected an OSHA proposal to require RMI to spend upwards of $100,000 to reduce noise exposure by means of engineering controls. (The employees affected were already wearing personal protection equipment.) Here the court treated the feasibility question as resolved, noting that a "consensus is developing among the circuits that the term [feasibility] should encompass both technological and economic feasibility" and that "[n]umerous cases have held that [OSHA] should weigh the estimated costs of compliance against the benefits reasonably expected therefrom when promulgating or enforcing a regulation." In short, the court explicitly affirmed the need to compare benefits and costs as a means of determining whether a proposed noise reduction measure was economically feasible.

### A Case Study Involving a GM Plant

As we have seen, both the Review Commission and the courts have found benefit-cost analysis essential to assessing the economic feasibility of OSHA's proposals for reducing occupational noise. Moreover, the courts have recognized that health and safety resources, just as all other resources, are limited and therefore should be allocated carefully, to ensure workers insofar as possible the greatest protection from the most serious risks. In what follows, we attempt to illuminate these precedents and their broader implications, as a step toward creating a model for future OSHA noise litigation. The case in point is a GM plant that was cited by OSHA in 1978 for having noise levels exceeding OSHA's noise standard in certain areas. At issue were ten types of high-speed stamping presses used to produce automobile components.

**. . . both the Review Commission and the courts have found benefit-cost analysis essential to assessing the economic feasibility of OSHA's proposals for reducing occupational noise.**

**Analysis of Benefits.** For many years, GM has maintained an extensive hearing conservation program that uses engineering and administrative controls supplemented by personal protection devices where, in the company's judgment, additional administrative and engineering controls are not feasible. From the standpoint of worker protection, how does this program compare with OSHA's proposal?

Table 1 compares the hearing protection afforded under the two plans. Taking GM's program first, the first three columns give the number of employees working in the areas cited, the ambient or measured noise levels (that is, without any protection for employees), and the level of noise actually perceived by the workers (that is, when wearing protection equipment). The figures for perceived noise in column 3 are based on the ambient noise data in column 2 and on the assumption that the personal protection equipment used in the GM program reduces noise by 26.6 dBA. (This figure is based on tests of the technical properties of the earplugs and earmuffs in use.) Thus column 3 presents our estimates of the levels of noise, around each type of equipment, that actually reach the employees' inner ears. This of course is the key figure in determining the potential for an adverse effect of noise. Under the GM program, the noise levels range from a low of 66.9 dBA for the pole piece press to a high of 80.0 dBA for the slitter press (where the operators presumably do not now wear personal protection equipment because the operation meets OSHA's standard).

Turning now to OSHA's proposal, the last three columns show how it would affect the GM workers. A glance at column 4 indicates that, in some cases, this proposal would actually increase the number of employees working in the noisy areas. This is because more workers would be needed to service the machines and to offset productivity losses if the machines were spaced out and placed in noise-suppressing enclosures (as called for in OSHA's pro-



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**Table 1**
NOISE PROTECTION BENEFITS—
GM PROGRAM VS. OSHA RECOMMENDATION

| | GM Program | | | OSHA Recommendation | | |
|---|---|---|---|---|---|---|
| **Type of Press** | (1) Number of workers | (2) Ambient noise (dBA) | (3) Perceived noise (dBA) [a] | (4) Number of workers | (5) Ambient noise (dBA) [b] | (6) Perceived noise (dBA) [a] |
| Transfer | 31 | 99.4 | 72.8 | 34 | 92.4 | 65.8 |
| High Speed | 32 | 98.4 | 71.8 | 34 | 91.4 | 64.8 |
| OBT | 7 | 94.5 | 67.9 | 7 | 87.5 | 87.5 |
| Straight Side | 22 | 96.4 | 69.8 | 31 | 89.4 | 89.4 |
| Welding | 26 | 94.0 | 67.4 | 27 | 87.0 | 87.0 |
| Pole Piece | 2 | 93.5 | 66.9 | 2 | 86.5 | 86.5 |
| Slitter | 8 | 80.0 | 80.0 | 8 | 80.0 | 80.0 |
| Link | 10 | 97.5 | 70.9 | 10 | 90.5 | 63.9 |
| 300 Ton | 31 | 99.4 | 72.8 | 32 | 92.5 | 65.9 |
| Frame | 17 | 95.4 | 68.8 | 17 | 88.4 | 88.4 |
| Total/Weighted Average Exposure [c] | 186 | 97.6 | 72.2 | 202 | 90.6 | 84.6 |

**a** Assumes the use of ear protectors producing an attenuation of 26.6 dBA in areas where noise exceeds 90 dBA.
**b** Assumes enclosures producing a mean attenuation of 7.0 dBA.
**c** Weighted by the number of workers in each equipment category; decibels averaged in antilog form.

posed remedy). Column 5 is based on the assumption that spacing the equipment out and providing enclosures would reduce the ambient noise level by 7 dBA in each case. (This figure reflects both experience with enclosures of the type OSHA recommended and a computer simulation of machine spacing prepared by a GM consultant.) Column 6, which gives our estimates of the noise levels that employees would perceive under OSHA's program, is based on two assumptions: first, that if ambient noise falls below 90 dBA, workers will no longer wear earplugs or earmuffs, so that perceived noise will equal ambient noise; and second, that if ambient noise remains above 90 dBA, employees will wear the plugs or muffs, which will reduce perceived noise by the 26.6 dBA assumed above. Our estimates of the perceived noise levels under the OSHA plan range from 63.9 dBA for the link press to 89.4 dBA for the straight-side press.

The totals in Table 1 show that, whereas 186 employees are now working in the areas cited, the number would be 202 under OSHA's proposal. Moreover, while the proposal would reduce ambient noise levels by an overall average of 7 dBA, it would actually increase *perceived* noise by 12.4 dBA on average. And presumably it is perceived noise that is of key importance to these GM employees.

Table 2, derived from the data in Table 1, shows the number of employees under both programs who would experience noise levels of 60 dBA and higher (rising in 5 dBA increments). Under OSHA's recommendation, 84 employees would experience noise exceeding 80 dBA, whereas no employees would experience that much noise under GM's program. This may be important because OSHA has claimed that some permanent hearing impairment may occur even at noise levels below 90 dBA (see, for example, 39 *Federal Register* 37773, October 24, 1974). However, there are few who claim that noise levels below 80 dBA do any such harm. These findings and OSHA's expressed concern over noise that is louder than 85 dBA imply that the recommended program, rather than generating benefits for the affected employees, might actually cause them physical harm.

**Moreover, while [OSHA's] proposal would reduce ambient noise levels by an overall average of 7 dBA, it would actually increase perceived noise by 12.4 dBA on average.**

**Analysis of Costs.** Compliance with OSHA's recommended program would require both one-time capital costs and recurring costs (wages, operating expenses, utilities, et cetera). In order to compare these two types of costs, we have chosen to convert all the estimated one-time costs to an annual basis, using an assumed interest rate of 10 percent. The results are shown in Table 3. For example, the noise reduction enclosures recommended by OSHA would cost $1.7 million to build and would have a useful life of five years. Using the appropriate amortization formula, we find that this is the equivalent of an annual cost of about $449,000. Similarly, the new press building required would cost about $4.8 million to build and



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**Table 2**
WORKERS EXPERIENCING NOISE OF 60 dBA AND ABOVE—GM PROGRAM VS. OSHA RECOMMENDATION

| Perceived noise (dBA) | Number of Workers | |
|---|---|---|
| | GM program | OSHA recommendation |
| Over 85 | 0 | 84 |
| Over 80 | 0 | 84 |
| Over 75 | 8 | 92 |
| Over 70 | 112 | 92 |
| Over 65 | 186 | 158 |
| Over 60 | 186 | 202 |

**Table 3**
ANNUAL COSTS OF OSHA'S RECOMMENDATION

| Type | Annual Costs (in thousands) |
|---|---|
| Capital Costs | |
| Construction of machine enclosures | $ 449 |
| Construction of addition to plant | 517 |
| Shutdown of press area | 91 |
| Relocation of equipment | 159 |
| Subtotal | $1,216 |
| Recurring Costs | |
| Direct labor | $ 168 |
| Indirect labor | 228 |
| Added operating expense | 293 |
| Additional utilities | 190 |
| Personal protection equipment | (2) |
| Subtotal | $ 937 |
| Total Costs | $2,153 |

would be expected to last almost twenty-nine years, which works out to an annual cost of some $517,000. As for the other one-time costs (shutdown and relocation), we have assumed they would not be depreciated, and have converted them to annual costs by multiplying them by 0.10, reflecting a 10 percent rate of discount.

These annualized capital costs, plus the recurring costs shown in the bottom half of the table, produce total compliance costs of a little over $2.1 million. If that cost is assigned to the total number of employees covered (202), the cost per employee is some $10,700 a year. Alternatively, if the cost is assigned just to those 74 employees who, under the proposal, would no longer be required to wear personal protection equipment, the cost per employee is over $29,000 a year. Both figures are, of course, much higher than the costs found economically infeasible by the Review Commision and the courts.

**Benefit-Cost Comparison.** It is difficult to relate the benefits of OSHA's scheme to the costs, for the simple reason that on the whole the scheme would apparently generate *costs* for workers rather than benefits. In any event, assuming our analysis is correct, adoption of OSHA's program would represent the worst kind of expenditure of the nation's resources. Spending initiatives might be categorized into four types, listed here in order of their desirability: (a) spending a given amount of resources and getting in return something that has greater value, (b) spending a given amount of resources and getting in return something that has less (though positive) value, (c) spending a given amount of resources and getting nothing in return, and (d) spending a given amount of resources and losing something in addition. The noise reduction program that OSHA has recommended for the GM plant appears to be of the last variety—it would impose compliance costs of about $2.1 million in return for more noise reaching the workers' ears.

**The noise reduction program that OSHA has recommended for the GM plant . . . would impose compliance costs of about $2.1 million in return for more noise reaching the workers' ears.**

## Concluding Remark

Our purpose here has not been to provide a simplistic formula for use in all future OSHA noise-reduction disputes. Rather, we have tried to show how economic analysis can help the Review Commission and the courts judge the economic feasibility of proposed noise-abatement programs. Such analysis can also be useful, we believe, to OSHA in carrying out its mandate—as well as to employers and employees in designing and evaluating the desirability of *voluntary* occupational safety and health programs. ■



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# THE "STATE" OF REGULATORY REFORM

Bruce E. Babbitt

THE JOB OF regulatory reform is fairly begun at the federal level—but that is only half the job. We must also intensify parallel efforts at the state and local levels. All around the compass, moreover, the goal is the same: to place increasing reliance on the competitive marketplace as our principal and "natural" regulator.

My own initiation to regulatory reform came when I was elected attorney general of Arizona in 1974. I was confronted at once with the bittersweet task of defending the state regulatory agencies against a tidal wave of complaints, grievances, and litigation brought by members of the public. And more often than not, the aggrieved consumer was right: regulation had itself become the biggest part of the problem. Even more disquieting, these new clients of mine often wanted to solve the problems of regulation by engaging in more of the same—urged on by the regulated occupations or industries. My only recourse was a crash self-education program to learn what it is these agencies do, and why.

What I discovered, of course, was that most of them had been spawned by the New Deal and steeped in post-depression attitudes of pessimism about the free market system. State legislatures, following the example of Congress, assumed that the best response to almost any problem was to set up a government agency to solve it. Even in such bastions of traditional laissez faire as Arizona, the legislature erected a vast array of "expert" administrative agencies with responsibility for virtually every imaginable sector of the economy—and some, as we will see, not so imaginable. Whatever the apparent justification, this mind-set systematically underestimated the marketplace and oversold government regulation as the preferred method of allocating resources and making economic choices.

Our experience with regulatory reform in Arizona—and I suspect it is typical—suggests that economic regulation tends mostly to benefit those being regulated and that it passes the costs, both needless and substantial, along to the public. Let me give some examples in three principal areas: rate and entry regulation, occupational licensing, and outright statutory prohibitions on competition.

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### Rate and Entry Regulation

In Arizona, as in many other states, bus and trucking companies are required to have public service certificates granting them monopolies on particular intrastate routes. The regulatory



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agency then maintains a rate-setting bureaucracy in order to prevent abuse of the monopoly power that the agency created in the first place. This regulatory framework replicates to some extent those found in federal regulation of air transport, trucking, railroads, and buses—where, happily, the controls are now being relaxed.

These monopoly operating certificates are bought and sold for enormous sums at both the state and federal levels—one good measure of the added costs that this type of regulatory scheme imposes on the public. It is governmental regulation pure and simple that creates "value" for an otherwise worthless piece of paper and, in turn, artificially inflates the cost of transportation. For example, several years ago a Tucson firm acquired from the Arizona Corporation Commission a common-carrier certificate allowing it to operate heavy trucks and machinery. But the company never purchased so much as a single truck. It simply leased its certificate to another operator. At the end of the lease period, the certificate holder—still with absolutely no tangible holdings, goodwill, or operating history—sold its "assets" to yet another company for $150,000. All it really had to sell, of course, was that original state-granted monopoly, whose purchase price will be amortized (as was the lease) by higher rates to consumers. Unhappily, this Arizona experience is much the same as that at the federal level where, for example, one company holds certificates from the Interstate Commerce Commission (ICC) to operate in twenty-two states, although it owns no trucks and no terminals. The company leased all of its licenses to actual operators and skimmed $7.7 million off the top.

State-granted monopolies are so valuable that their holders—like all good monopolists—fight hard to keep them. Again, it is the public that suffers. An Arizona monopoly carrier whose vans are specially equipped for serving the handicapped is actually suing one charitable organization for daring to provide free transportation to needy handicapped persons. Such service, according to the suit, whether for free or for pay, is solely the province of the certificated carrier and may not be offered by others. The sorry fact is that tariff restrictions do preclude other entities even from possessing the vehicles needed to serve the handicapped. More outrageous still, Handi-car Inc. has obtained a court order preventing the city of Tucson from contracting with government agencies to provide transportation services to the handicapped or from providing free service to the low-income handicapped who would normally be the monopoly's customers or have insurance coverage for such services.

Moreover, monopoly privileges can lead to utterly absurd results. For example, riders who board one major company's buses in Phoenix can be carried *through* but not *to* Flagstaff. The buses stop there to pick up passengers headed out of state, but passengers boarding in Phoenix cannot be allowed to disembark because the company does not have service rights between Phoenix and Flagstaff. For a similar crazy reason, passengers cannot travel from Phoenix to Tuscon on the buses of another major carrier, even though the buses stop in Tucson to discharge travelers from out of state. The innocent passenger confronting such no-no's is sometimes amused, often puzzled—and always frustrated.

So it is more than time for the state legislatures to follow the lead of the U.S. Congress—emulating its actions in air and surface transportation—and move to deregulate intrastate transportation. While estimates differ, it is reasonable to conclude that federal and state deregulation of trucking, buses, and taxis would probably save consumers a cool $6 to $7 billion a year. I made transportation deregulation my top legislative priority last year and lobbied with a coalition of citizens groups to push it through. To the surprise of many, we were successful in totally dismantling rate and entry regulation of trucking within the state, subject only to a constitutional referendum that will be on the ballot this November. (Responsibility for safety regulation will be moved from the public utilities commission to the Department of Transportation.)

Some of the opponents complain that small towns will be the losers—that they will be denied service now required as a condition of certification. They argue that inflated profits on monopoly routes—between Phoenix and Tucson, for example—are necessary in order to subsidize service to the less profitable outlying areas of the state. Yet, all of the available evidence suggests that there is in fact no such cross-subsidization of trucking service and



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that, for a host of reasons, trucking deregulation is more likely to benefit than harm small communities. Moreover, if we must have subsidies for such service, they should not be hidden in the maze of rate regulations. Instead, subsidies should be openly sought and openly granted, so that the public can fairly evaluate whether they are needed and worth the price. The federal Airline Deregulation Act of 1978 provides an example: it contains a subsidy program tied directly to the maintaining of service to small cities and towns. Experience with that act is exemplary in another way as well: after one year of airline deregulation, the CAB found that fares had fallen, that flights and passenger loads had increased overall, and that new airlines were receiving interstate authority for the first time in many years.

Our efforts in Arizona to deregulate motor carriers have engendered some unlikely alliances. Most of the regulated bus, truck, and taxi companies—the certificate holders, that is—are fighting hard to preserve monopoly regulation, notwithstanding their usual complaints about government interference with private enterprise. Considerable sums are being spent to convince the voters that monopoly transportation is necessary—that small communities will be abandoned, indeed that rapists will become cab drivers—if the regulated monopoly system is eradicated. This referendum battle in Arizona bears watching. It may tell us which way the winds of change are blowing, and how hard, both for deregulation in general and for the deregulation of transportation systems in particular.

## Occupational Licensing

The granting of occupational permits to lawyers, doctors, geologists, surveyors, landscape architects, and myriad other callings is a traditional state function, long justified as a way of guaranteeing quality service and protecting consumers from fraud. A number of recent studies strongly suggest, however, that occupational licensing more generally protects those in the regulated occupation than it does the consumer of the service. Too often, licensing boards use their statutory powers primarily to restrict entry and prevent competition. The economic effect is not to make the market work better but rather to transfer income from the consumer to the service provider. In some instances, occupational licensing boards have simply become the captives of the very professions they are supposed to regulate. By way of illustration, here are a few examples that we uncovered while reviewing Arizona's occupational licensing practices.

In Arizona, as an article noted in these pages just two months ago, the course of instruction for barbers requires a minimum of 1,250 hours of study, more class time than is generally needed to obtain a law degree in most American universities. The 1,250-hour requirement includes no less than 250 hours devoted to such esoteric subjects as bacteriology, the structure of the head, face, and neck, and the various diseases of the skin, hair, and glands. With refreshing candor, the chairman of the state Board of Barber Examiners recently admitted that such regulation was necessary "to protect the barbers." Without such stringent requirements, he added, "anyone can come into the state and become a barber." Barbering, however, is for beginners. Cosmetology—a more sophisticated art—requires 1,800 hours of instruction!

Another example: In Arizona there is reciprocity for dentists entering from other states—but only if they do not charge for their services. The state Dental Board prohibits such "alien" licensed dentists from practicing dentistry for a fee unless and until they pass the state exam. They may, however, with a special permit, practice on a volunteer basis for charities. The anticompetitive animus of such a policy could hardly be plainer.

Some of the most interesting examples that we found involve the Registrar of Contractors, whose regulations embody an elaborate market division scheme. In the first place, specialty contractors are protected from encroachment by general contractors. Because a general contractor's work must involve "more than two unrelated trades," he or she can build a sidewalk or patio wall if it is part of a larger job—like building a house—but not if that is all that is wanted. Moreover, any one type of specialty contractor is protected from competition from all other types—and the list is endless. There are separate licenses for floor covering, carpet installation, composition floor, marble, masonry, terrazzo, tile (ceramic, metal,



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and plastic), and wood floor laying, not to mention numerous categories of carpentry and remodeling. There are several hundred specialty licenses in all, and the regulations spell out in detail the scope of work permitted under each license. A craftsman may hold several licenses, of course; but there are separate bonding, examination, and experience requirements for each one. Incidentally, a recent exemption for "handymen"—for jobs under $500—applies only if any advertising by such persons states that they are *not* licensed. Some come-on! A Contractor Study Commission now has these problems under review and will report to the legislature and to me on January 1, 1981.

Even in Arizona, a free market state—or so we are proud to claim—more and more occupational groups are demanding regulatory agencies of their own as shelters from the vicissitudes of competition. My office has recently been flooded with demands that palm tree trimmers be regulated. Now, the trimming of palm trees is a venerable trade in Arizona, usually plied by college students, itinerants, and others who like occasional piecework and are unafraid of heights. In this particular case, the demand for regulation is coming not from those itinerant trimmers but from licensed landscape architects who claim that palm-tree trimming is part of *their* regulatory turf. Landscape architects frequently voice similar complaints—and demand prosecution—against unlicensed entrepreneurs caught planting lawns and trees and doing similar work suitable only for landscape architects. (When I was attorney general, barbers claimed that the cosmetologists' use of barber poles as decorations constituted "unfair competition.") At this point I am happy to report that a Board of Palm Frond Cutters does not appear to be imminent.

Obviously we cannot do away with all occupational licensing. Nor should we. Doctors and lawyers ought to be licensed, and probably security salesmen as well—even if landscape architects should not. Some rules are needed to protect consumer health and safety from the incompetent, but we should be careful not to extend license laws beyond this narrow justification—stringently applied. So, case by case, we must take a careful look at the true regulatory purpose and consider how best to accomplish it with minimal restraint on entry and price competition. We must be particularly skeptical of any regulation, whatever its guise, whose outcome is predictably protectionist. And insofar as genuine health and safety justifications can be adduced, we must search out the least restrictive means to protect the public interest.

### Statutory Prohibitions on Competition

Along with rate regulation and occupational licensing, a third major area of needed reform is that of statutory bans on competition. In Arizona we repealed our fair trade laws in 1976, but that was only the first step in the process of needed reform.

"Unfair" sales laws—which are, like fair trade legislation generally, a product of the depression—prohibit retailers from selling below some prescribed markup. The minimum markup in Arizona was 12 percent. Their purpose is to protect retailers from competition, "unfair" or otherwise. Whatever validity this idea may have had forty or fifty years ago, its time has certainly passed. Government has no business insulating the inefficient from competition by mandating that the consumer pay a higher price. "Unfair" cuts both ways.

In the same vein is the assortment of state laws that prohibit certain businesses and professions from advertising. The landmark case of *Bates* v. *State Bar of Arizona* began while I was attorney general; the U.S. Supreme Court's decision in this case guarantees the right of lawyers to advertise and of consumers to shop for the lowest price. Since *Bates*, we have been able to prevent professional trade organizations from prohibiting advertisements by their members. For example, the State Bar has adopted a new conduct code that prohibits only "unprofessional" advertising.

But this battle is by no means over. Across the country, many states still have laws that prevent consumers from doing comparison shopping through the perusal of advertising. These include bans on advertising by denturists in Alabama and optometrists in Oklahoma, and a number of state laws that prohibit the advertising of such specified medical services as cures for venereal and other "sexual diseases." Until all such laws are rooted out, competition will still be foreclosed and consumers denied the benefits of the lower prices and the greater



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availability and quality of services that come with increased competitive marketing.

### Sunset Laws . . . and Other Disciplines

Another important vehicle of regulatory reform is sunset legislation—which typically mandates termination dates for regulatory and other governmental programs, subject of course to explicit renewal by the legislature. Initially I was a skeptic about this approach, but experience has taught me how effective it can be. The first round of agency performance audits under Arizona's sunset law, passed in 1978, led to a few outright fatalities and served in other cases to publicize the inadequacies—sometimes blatant failures—of the agencies involved. The state sunset movement began in Colorado only four years ago. Since then, thirty-three states have followed suit. And, as experience in Arizona shows, the benefits are measurable in more than just the gross "body count" of agencies abolished and dollars saved. Equally important is the way in which performance audits can lead to better oversight, more finely tuned regulation, and greater competition.

Some of the reforms I have been suggesting require statutory change. But quite apart from new statutes (or none at all), high quality appointments may be an equally important vehicle of regulatory reform. All of us in the executive branches of government, at whatever level, have the opportunity to impart a new regulatory philosophy by our appointments to licensing and regulating bodies. Alfred Kahn's work at the CAB and Darius Gaskins's work at the ICC are striking examples of what one appointee can do.

Putting the "right" people on regulatory boards is nowhere so simple as just finding them, however: many state laws mandate that most or all members of licensing boards be chosen from the professions being regulated. An extreme example in Arizona is the dental board. Under our statutes I am limited to appointing those dentists—and only dentists—specifically recommended to me by the Arizona State Dental Association. This requirement falls just short of outright delegation of regulatory authority to the profession itself, a case of the rabbit guarding the lettuce patch (which puts an almost intolerable burden on even the most public spirited of rabbits). As a result of this sweetheart relationship, the Arizona dental board has become an arm of the association, not necessarily attuned to public needs—or at least with a "higher" and conflicting loyalty. For many years now, that board has not suspended the license of a single dentist. But in those years the board has, at the urging of the dental association, spent most of its energies attempting to prevent denturists—the paraprofessional technicians who make dentures—from cutting into the dentists' traditional preserves. The anticompetitive impact is plain.

One way of controlling this type of abuse is to put lay representatives on professional licensing boards. California has led the way in this regard, requiring a majority of lay members on most of its occupational boards. In Arizona, the legislature has begun to follow this same route, although we still have far to go. The results can be dramatic. The appointment of one aggressive, public-spirited citizen to our funeral board transformed that previously scandal-ridden agency into something of an exemplar for the nation.

Finally, let me note that strengthened state antitrust enforcement is a necessary corollary to the deregulation effort. Once we do away with legal rate-setting, statutory price-fixing, and regulatory barriers to entry, we must see to it that private parties do not attempt to carry on what the government was doing before. All of our experience indicates that the risk is real. Indeed, even *with* regulation, private firms and individuals have been known to engage in anticompetitive activity quite on their own.

REGULATORY REFORM, believe me, does not come easy. It is generally opposed by strong, well-financed special interest lobbies which, using the shield of regulation to fend off the rigors of free enterprise, have grown lazy and noncompetitive. It is difficult to highlight these issues in a way that commands public support. But it can be done. And once legislators and the public become aware of the full costs of regulation and the harm done to consumers, the idea of reform can be politically irresistible.

So, whatever the course of regulatory reform at the national level, it is a truism that the federal government cannot do the whole job. Our challenge in the fifty states is to regulate less ourselves—and do that "less" better. ■



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## A Case of Fortuitous Regulatory Expansion

# Inflation and the NLRB


## Bernard D. Meltzer

with Robert J. LaLonde


THAT INFLATION distorts public and private policy in unanticipated ways is a melancholy commonplace of our time. A familiar example is the effect that inflation has on the progressive income tax, propelling taxpayers with larger nominal incomes into higher and higher brackets even though their real incomes have not increased. Less publicized is the subtle and equally unanticipated way in which inflation broadens the reach of any regulatory program whose jurisdiction is defined in fixed dollar terms. This process has been at work, as we shall show, in the field of labor regulation.

### Setting the Stage

The possibility of inflation-induced distortion in the operations of the National Labor Relations Board (NLRB) was latent in Congress's response in 1959 to what was then a gap or jurisdictional "no-man's land" in governmental regulation of labor relations. That gap had been caused by two factors. The first was the NLRB's determination, for budgetary and other reasons, to put practical limits on its extremely broad statutory jurisdiction (which extends to virtually all firms). Initially the board took the approach of declining to exercise jurisdiction on a case-by-case basis, but beginning in 1950 it shifted to the use of industry-by-industry jurisdictional yardsticks stated largely in terms of dollar minima. The second factor causing the gap was the Supreme Court's decision in *Guss v. The Utah Labor Relations Board* (1957). There the Court held that the NLRB's refusal to act did not necessarily permit action by state labor boards or state courts, since the federal government continued to preempt most of the field. As a result, a substantial segment of the nation's business enterprises, those falling between the expansive scope of the commerce power and the NLRB's self-limiting jurisdictional yardsticks, were in a no-man's land where the national board would not enforce federal law and state boards and courts could not enforce any law at all (federal or state).

In the Landrum-Griffin Act of 1959, Congress responded to this bizarre situation by enacting section 14(c) of the labor act. Section 14(c) affirmed the authority of the board to decline to act in labor disputes when it deemed their impact on commerce to be insufficient. It also eliminated the no-man's land by permitting state bodies to act in disputes that the board declined to handle. But then, mindful of concerns expressed in the Landrum-Griffin debates that some states might engage in anti-union activities, Congress limited the board's freedom on the jurisdictional question. Specifically, it prohibited the board from declining jurisdiction over labor disputes involving firms that met the jurisdictional yardsticks prevailing on August 1, 1959—which implied, of course, that the board could not reduce its jurisdiction by raising the yardsticks.

Thus, by 1959 the stage was set for an inflation-induced expansion in the NLRB's effective jurisdiction. The 1959 standards (announced in 1958) spelled out the minimum annual dollar volumes of business that would be a prerequisite for the board's assertion of jurisdiction over firms in different industries. For example, the yardstick for department stores specified an annual sales volume of $500,000. So far, so good. But two decades later $500,000 in sales, adjusted to 1978 dollars to account for inflation, is the equivalent of $1.1 million in sales. Or to put it another way, to apply a


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$500,000 standard in 1978 is the equivalent of applying a standard of only $225,000 in 1959. Thus in two decades the minimum size of the qualifying department store was cut in half.

### A Clear but Unmeasured Effect

Evidently, then, inflation has significantly expanded the reach of the board's yardsticks. It is not easy, however, to determine precisely the extent of that expansion—or its effect on the functioning of the agency. The difficulty is partly one of insufficient data. Typically the opinions handed down by the board state only that the firm involved meets the applicable jurisdictional yardstick and do not specify how much over the minimum the firm's sales may be. Accordingly, those opinions do not provide a basis for determining whether a given firm would meet the pertinent yardstick today if that yardstick were indexed for inflation.

A second difficulty is that it is not proper to estimate the expansion in caseload simply by extrapolating from the rate of inflation. That extrapolation would be reliable only if three factors were known: (1) the actual distribution of firm sizes for all types of industries, (2) the percentages for firms that would have satisfied the board's yardsticks in 1959, and (3) the relationship between the board's caseload and the number of firms satisfying these yardsticks. One obstacle to the usefulness of such extrapolation is that the impact of inflation on the coverage of a jurisdictional yardstick is a function of the percentage of firms not covered before the inflation. In other words, the larger the segment of uncovered firms to begin with, the greater the impact of a given rate of inflation.

But even if we had the data needed for determining the percentage increase in the number of firms brought within the board's yardsticks because of inflation, we would still not be warranted in projecting a corresponding increase—or indeed any particular increase—in the board's *actual* caseload. This is true primarily for two interrelated reasons. The firms that inflation sweeps within the board's yardsticks are the relatively small firms. And within that group, it is mostly the larger firms that become involved in board proceedings. An obvious reason for this possibility is that the board's work is increased by union-organizing campaigns and by the collective bargaining that follows the recognition of a union. It would be understandable if unions often concluded that the gains from organizing and representing a relatively small number of employees dispersed over many small firms did not warrant the time and expense involved. As a result, the increase in caseload is likely to be less than coverage of the yardsticks.

Even so, available evidence indicates that cases involving smaller firms have become a larger proportion of the board's docket. The percentage of "situations" involving firms with less than ten employees rose from 19.9 percent in 1965 to 28.2 percent in 1978,* according to the NLRB's annual reports for those years. Furthermore, information supplied informally by an NLRB official suggests that the number of establishments covered by the board's jurisdictional yardsticks rose at a faster rate from 1959 to 1972 than the number of employees covered by those yardsticks. Although this evidence supports our intuition that inflation has increased the board's caseload, the difficulty of estimating that increase precisely remains.

### A Swelling Caseload

In any event, the board has confronted an ever-increasing and much-bemoaned caseload. The entire agency disposed of 39,652 unfair labor practice charges in 1978, compared with 11,357 in 1960—as well as 13,609 union election proceedings in 1978, compared with 10,170 in 1960. The overwhelming majority of those matters were, however, screened out or settled without adjudications by the presidentially appointed members of the board itself. Nevertheless, as was to be expected, the number of contested unfair labor practice cases decided by those members increased sharply from 1960 to 1975. During that period, by contrast, the number of representation decisions made by board members declined significantly, largely because the NLRB had delegated most of its powers over representation to regional directors, in accordance with the authority granted it by the Congress in 1959. Incidentally, also during that period, the agency's budget (in real dollars) in-

* The board defines a "situation" to be "one or more unfair labor practice cases involving the same situation."



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creased at approximately the same rate as the agency's workload, while the increase in its staff lagged somewhat behind. The number of board members has not increased since 1947, when Congress expanded the board from three to five members and authorized it to make decisions in three-member panels.

In coping with its increased load, the NLRB has been subject to a limitation not applicable to some other agencies—that is, the NLRB has not been given authority to delegate decision making to agency employees, except in election proceedings (where, as indicated above, it has used that authority liberally). Indeed, so insistent was Congress that decisions be made by the presidentially appointed members of the board that the Taft-Hartley Act prohibits the NLRB from employing lawyers for reviewing transcripts and the like. This prohibition was designed to eliminate the agency's Review Section, which (before Taft-Hartley) had served as a pool of lawyers for the board members, collectively. Yet, while closing down the Review Section, Congress opened a back door to such use of lawyers by permitting each board member to hire an assistant or assistants. How then did the board manage almost to quadruple its output of unfair labor practice decisions between 1960 and 1975? According to ex-Chairman Edward B. Miller, the explanation lies in the replacement of the Review Section with five separate twenty-lawyer staffs, one attached to the office of each of the five board members—with corresponding dilution of the members' personal participation.

The increase in caseload that has produced this bureaucratization of the board is, of course, not solely the result of inflation. Our population and economy have grown larger. Moreover, Congress has expanded the agency's jurisdiction—by extending it to approximately 650,000 postal workers in 1970 and to employees of nonprofit hospitals (who had been excluded by the Taft-Hartley Act) in 1974. And the NLRB itself has, by adjudication, repudiated prior self-limiting policies and has asserted jurisdiction in new fields bristling with difficulties—such as proprietary hospitals, private nonprofit universities, secondary schools owned and operated by religious institutions, and law firms. Furthermore the NLRB—by virtue of the ambiguity of, and fluctuation in, its substantive doctrines—has invited litigation on difficult issues, such as the duty to bargain and "free speech" during election campaigns.

But inflation has doubtlessly played a significant role in increasing the agency's load—a role not even mentioned in the legislative debates preceding Congress's decision to lock in the 1959 jurisdictional standards by enacting section 14(c). Plainly, the extent of inflation's impact should be of interest not only to the board when it formulates discretionary policies but also to Congress when it considers—as it should—whether it will permit the NLRB to "index" its jurisdictional standards or whether it will undertake the task itself.

As we have said, we can do no more here than note the probable importance of the NLRB's inflation-produced jurisdiction and caseload. To achieve a more precise analysis, several methods are available. One would be a case-by-case inquiry into the amount of business done by firms that are parties to board proceedings—a formidable and expensive inquiry. More feasible would be a random sampling of the firms involved in board cases during a given year in order to obtain figures on firm size. Finally, perhaps census data on the distribution of firms by size could provide the basis for a workable estimate—although we, as well as the board's staff, have found those data insufficient.

### Inflation and Fortuitous Regulatory Expansion

In any event, the impact of inflation on the bite and broadening of regulation merits further study. And not only, it should be added, with respect to the NLRB. Programs implemented by many other agencies—for example, the exemptions from various registration requirements of the Securities and Exchange Commission, not to mention definitions of grand larceny—are also subject to financial yardsticks that endemic inflation can quickly render obsolete. On the other hand, some may be comforted to learn that the First Congress in proposing the Seventh Amendment to the Constitution in 1789, and the states in ratifying it in 1791, were apparently oblivious to the surprises inflation can bring: the Seventh Amendment preserves a right to jury trial in suits at common law when the value in controversy exceeds twenty dollars. ■



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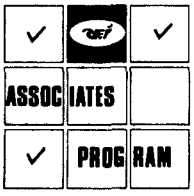


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# Readings
## of particular interest

### Shared Monopoly

*Shared Monopoly and the Cereal Industry* by Brian F. Harris (East Lansing, Michigan: Division of Research, Graduate School of Business Administration, Michigan State University, 1979), 169 pp.

The Federal Trade Commission's shared monopoly case against the three largest breakfast cereal manufacturers will, according to the author of the monograph, have important implications for government antitrust policy and marketing practices in concentrated industries. The FTC is charging that Kellogg, General Mills, and General Foods have created and share a monopoly primarily by using similar nonprice marketing practices in new product development, advertising, and sales promotion and by controlling how much shelf space retailers allocate to their brands. These practices, the commission claims, have deterred entry into the industry and allowed concentration levels to remain high, resulting in overcharges of 15 to 20 percent for breakfast cereal. The overcharges could be reduced if the manufacturing sector of the industry were restructured, with the major manufacturers being required to first divest themselves of a number of their plants and then to license on a royalty-free basis a number of their established trademarks. (The latter requirement would be unprecedented.)

Brian F. Harris, professor of marketing at the University of Southern California, finds that the "most unique feature of the case is the FTC's use of the term shared monopoly in place of the more traditional term, oligopoly," and that the distinction makes a difference. "For the first time in U.S. antitrust history, a number of firms have been charged formally with sharing a monopoly."

In analyzing the FTC's novel approach, the author identifies two bases for the shared monopoly theory. First, extending oligopoly theory to include nonprice marketing practices of firms in differentiated oligopolies, the FTC argues that these practices constitute unfair methods of competition and violate section 5 of the FTC Act. Second, the FTC contends that, even if a tacit conspiracy does not exist, there is a direct relationship between the structure of the cereal industry and its performance. In other words, regardless of the behavior of firms, the existence of certain structural characteristics—high concentration, stable firm market shares, high entry barriers, and high product differentiation—provides sufficient evidence, per se, to constitute a violation of section 5 of the FTC Act.

Harris notes, however, that for the first time, the structuralist model is being applied to a segment of the food industry in which manufacturers and resellers affect the overall performance of the industry, especially the level of retail prices. Therefore, the restructuring of the manufacturing sector of the industry would not guarantee that resellers respond in ways to cause retail prices for cereal products to fall.

The author develops a theory of reseller decision making and uses it to analyze the possible effects of the proposed remedies on the pricing behavior of wholesalers and retailers. He concludes as follows: First, the entry of new cereal manufacturers that would occur under the proposed restructuring order would not guarantee lower retail prices. In fact, the adverse effect of a larger number of manufacturers on profit contributions of cereals at the reseller level could force wholesalers and retailers to increase selling prices. Second, by raising distribution costs, the FTC's restructuring remedies could simply reallocate profit margins between manufacturers and resellers without causing any decrease in retail price levels. Third, contrary to the claim of monopoly theory that heavy advertising by the large manufacturers is a major cause of high retail prices,



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this advertising allows wholesalers and retailers to achieve profit contribution objectives at *lower* levels of gross margins and selling prices.

Harris concludes that "to achieve a significant reduction in cereal retail prices, reseller profit margins would also have to be reduced," perhaps requiring that "the reseller sector of the industry would also require restructuring." That would, however, "greatly increase the complexity of the problem and the regulator's task." Clearly, the structure, behavior, and performance of both manufacturers and resellers must be considered when devising an antitrust policy designed to improve the price performance of any industry with structural characteristics similar to the breakfast cereal industry.

## Incentives as the Mother of Invention

*The Impact of Tax and Financial Regulatory Policies on Industrial Innovation* by Joseph J. Cordes, in cooperation with the Committee on Technology and International Economic and Trade Issues and the National Academy of Engineering (Washington, D.C.: National Academy of Sciences, 1980), 34 pp.

It is generally agreed that the climate for industrial innovation in this country has worsened, with serious implications for the well-being of the U.S. economy. In this monograph, economist Joseph J. Cordes of George Washington University identifies the federal tax and financial regulatory policies that significantly affect the innovation process and attempts to determine whether recent changes in those policies have encouraged or discouraged technological innovation.

Historically, investments in technological innovation have offered the potential of high returns in exchange for high risk. A government policy for encouraging innovation must deal, according to the author, with four areas: general economic stability, the climate for capital investment, incentives for research and development, and support for small technology-based firms. First, Cordes argues that an unstable recession-prone economy increases uncertainty about future profits generally and therefore discourages all investment. But technological innovation may be particularly sensitive to basic economic instability, because investment in innovation requires long-term financial commitments. It follows that policies that improve the stability and promote the rational growth of the economy will also encourage innovation.

Second, the general level of industry's capital spending also affects the level of innovative activity, because much of the application of innovation is in new capital equipment. Therefore, measures that stimulate new investment necessarily speed the spread of innovations throughout the economy. In Cordes's view, while the corporate tax changes made in the Revenue Act of 1978 should increase corporate investment and therefore provide some stimulus to innovation, their effect is likely to be modest. A much more significant factor, tending in the opposite direction, is the failure to adjust the corporate tax base for the impact of inflation, thus reducing the real value of depreciation deductions. To encourage investment in capital goods generally and innovation in particular, depreciation should be allowed on the basis of replacement rather than historical costs.

Third, since R&D is obviously an important component of the innovation process, tax incentives to stimulate additional R&D are one means of stimulating innovation. Section 174 of the Internal Revenue Code provides that firms may deduct certain R&D outlays from income as a current expense, but may not expense the cost of the plant and equipment used in R&D or the costs of patents or processes. Cordes recommends that section 174 be changed to allow the immediate expensing of such R&D-related asset costs or to extend tax credits to those expenditures. This change would have its major effect on such industries as pharmaceuticals, where R&D costs are a substantial portion of the total costs of innovating.

Finally, Cordes finds that while several features of the tax code favor small businesses, others may unintentionally discriminate against them, particularly if they are new. Small firms benefit from progressive taxation of corporate earnings, deduction of dividends paid to shareholders of regulated investment companies, treatment of corporations with fifteen or fewer shareholders as partnerships



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for tax purposes, and various provisions that permit individual investors to deduct from ordinary income investment losses in small businesses. On the other hand, loss offsets, depreciation deductions, and investment tax credits are helpful only to the extent that a firm, large or small, is profitable. To make sure that such measures are useful to new, initially unprofitable firms, Cordes recommends that their period of availability should be lengthened.

In addition, in light of the importance of equity financing to small technology-based firms, the author examines a variety of policies for encouraging such investment. These include reducing capital gains tax rates, liberalizing deductions for capital losses, allowing investors to roll over equity investments in small technology-based firms on a tax-free basis (provided any gains are reinvested in similar enterprises), modifying SEC regulations that restrict the rate at which investors may resell securities, adjusting the Regulation-A registration limit to reflect inflation, and ensuring that ERISA guidelines do not unduly discourage pension fund managers from investing in new, potentially high-risk technology ventures.

Whatever steps are taken, the author encourages a new commitment to innovation. Without it, he sees a further erosion of America's productivity and competitive edge.

## The Seabrook Experience

*Seabrook and the Nuclear Regulatory Commission—The Licensing of a Nuclear Power Plant* by Donald W. Stever, Jr. (Hanover, N.H.: University Press of New England, 1980), 248 pp.

Taking a critical look at the Nuclear Regulatory Commission's licensing procedures, Donald W. Stever of the Department of Justice (formerly assistant attorney general of New Hampshire) analyzes the events and proceedings that led to the construction of a 2200-megawatt nuclear power plant at Seabrook, New Hampshire. The book begins in 1971 when the Public Service Company of New Hampshire (and its partners) first proposed Seabrook to the state's siting board. It traces the project through a maze of state and federal regulatory procedures and examines the antinuclear civil disobedience the project generated.

The four major issues raised by the Seabrook case—site suitability, risk assessment, financial qualification, and environmental impact evaluation—constitute the core of the analysis. Stever argues, to begin with, that preliminary site selection by utility management underemphasizes values of importance to future opponents and that state site-screening procedures have proven inadequate to cope with controversial issues. The result is inevitable controversy before the NRC, whose procedures are inadequately designed to resolve it.

From this perspective, Stever goes on to evaluate the NRC's reactor-siting criteria. Noting that the AEC's original criteria were apparently intended to compel the location of nuclear plants away from large concentrations of population, he describes how the AEC, in a series of subsequent decisions, began approving sites that were closer and closer to populous areas, and doing so without adopting any cognizable standard. This history explains how the NRC came to approve the Seabrook site, in spite of substantial population exposure and the questionable ability to evacuate an adjacent resort area. Policies such as this, Stever contends, contributed to civil disobedience at Seabrook and widespread public dissatisfaction with the NRC.

Second, Stever grapples with the problem posed by human risk assessment, evaluating various proposed methods for accomplishing it. He concludes that, although current NRC practice represents an unstated judgment that the level of risk is acceptable, there is no analytical basis for that judgment.

Third, on the financial qualification question, Stever notes that the Public Service Company of New Hampshire, with only Unit 1 under construction, is already in serious financial trouble. It has had to divest itself of a large portion of its ownership interest in the plant, is having trouble raising money to complete the project, and is facing rate difficulties before the state public utilities commission. This situation could have been anticipated: the testimony before the NRC contains compelling evidence of PSCNH's inability to finance the project. The commission, however, rather than reject PSCNH's license application, deliberately reformulated its financial qualification standard, rendering it essentially a nonstandard. The so-called Seabrook rule allows a utility to meet



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the financial test merely by showing a history of favorable rate treatment at the hands of state authorities. Unfortunately for the PSCNH, the New Hampshire regulatory climate soured dramatically after its plant was licensed by the NRC. As an alternative to the Seabrook rule, Stever suggests a five-point test aimed at determining the applicant's ability to raise needed capital on the open market and the potential impact of a long-term shutdown of the facility on the applicant's system and on its financial stability.

Turning to the environmental issues raised in proceedings, Stever discusses the NRC's environmental impact analysis, its methodology for considering alternatives to a proposed project, and the interactions between the Environmental Protection Agency and the NRC. He finds that "where the thirst for energy is large and the economic commitment to a project significant, the government's ability to say no based on speculation about future damage to an ecosystem must be doubted."

The book concludes with a study of the opposition to the project, tracing its growth from a small coalition of citizen groups to an aggressive sophisticated opponent, and then its fragmentation into two camps—those willing to work within the legal system and those choosing civil disobedience. Stever concludes that antinuclear civil disobedience is harder to justify on a theoretical basis than similar acts aimed at racial injustice or government policies that are felt to be illegal or unconstitutional themselves. In the author's opinion, however, the procedures for citizen-group participation in the licensing process may be so restrictive that they may well foster the frustration with the system that led to confrontation.

## Politics, Pressures, and Nuclear Power

"Congress, Regulation, and the Decline of Nuclear Power" by Barry R. Weingast, in *Public Policy*, vol. 28 (Spring 1980), pp. 231-255.

The "producer protection" model of regulation, which holds that a regulatory agency's policy making is likely to be captured by the industry it regulates, may be useful in explaining the behavior of the Interstate Commerce Commission and Civil Aeronautics Board, at least in the days before deregulation. But, according to Barry R. Weingast of the Center for the Study of American Business at Washington University, the model has its limitations. Weingast examines the Atomic Energy Commission and its successor, the Nuclear Regulatory Commis-

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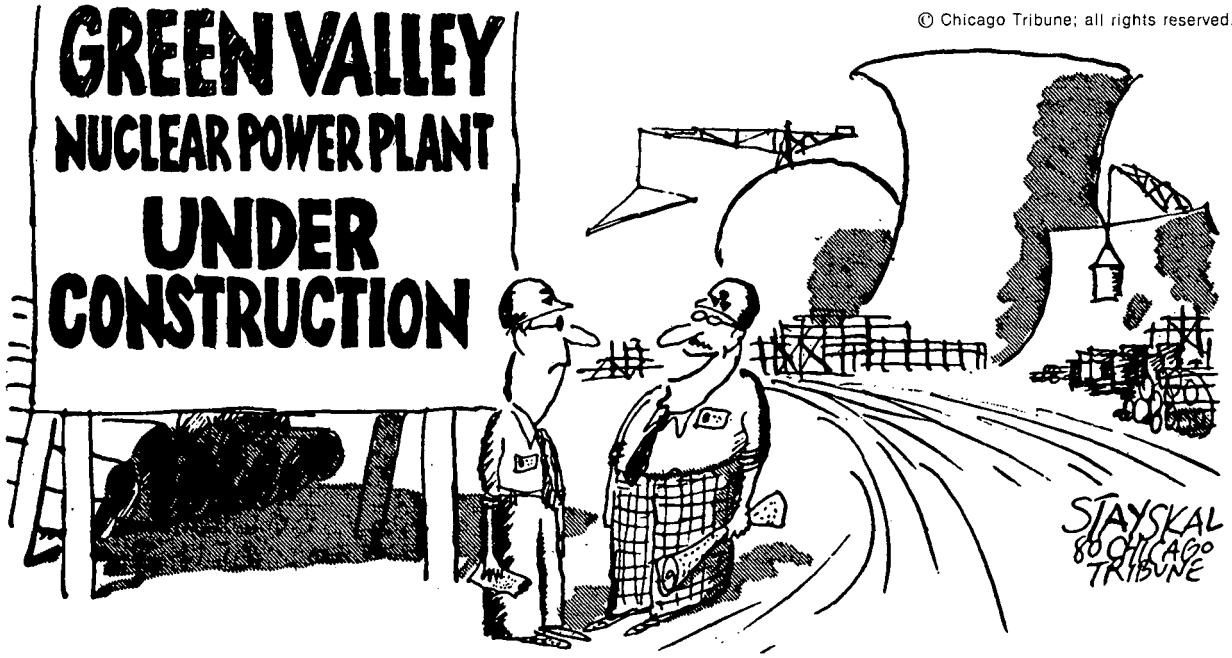


*"We were plagued with protesters until we spread the story that this used to be the site of an old chemical waste dump."*



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sion, concluding that their behavior is better explained by a pluralist, or multi-interest group model in which an agency responds to both producer and nonproducer pressures.

Economists developed the producer protection model as a reaction to the older "public interest" model, which had depicted regulatory efforts as disinterested attempts by government to remedy market failures and thus advance the general well-being. The new model seemed to explain the propensity of agencies like the CAB and ICC to shield their industries from competition. Analysis of the origins of the agencies often revealed that there had been no real market failure to remedy in the first place. In addition, the "capture" of an established agency can be explained by the relative ease of coalition building. Producers are generally fewer in number and have a more concentrated interest in regulatory decisions than consumers or potential competitors. Lobbying by producers has smaller organizational costs and fewer "free rider" problems, and is thus more likely to be effective.

But, Weingast argues, the producer protection model does not explain the behavior of the newer regulatory agencies whose jurisdiction cuts across industry lines—agencies like the Occupational Safety and Health Administration, the Environmental Protection Agency, and the Consumer Product Safety Commission. Few observers believe that these agencies have been captured by the industries they regulate. According to Weingast, the behavior of these agencies can best be explained by what he calls a "multi-interest group influence model," in which producer and nonproducer interests vie for influence.

The Atomic Energy Commission/Nuclear Regulatory Commission regulates only one industry, nuclear power—which the AEC was originally designed to promote. But during the 1960s, Weingast says, the AEC gradually changed from an agency largely influenced by producers to one influenced by a range of pressure groups, particularly environmentalists. As the pressures changed, so did the agency's behavior: regulation became far more complex and stringent, construction delays drove up the cost of nuclear plants, and applications for new reactor permits dropped off sharply.

In the early years of the industry, both Congress and the AEC sought to encourage the development of nuclear power through such measures as the Price-Anderson Act (which limited liability for nuclear accidents), federal stockpiling of uranium, and a program of outright subsidies. It was only after the termination of direct subsidies in 1963, ironically, that the industry began to take off. Orders for new reactors, which had been averaging only about one a year, rose to seven in 1965, twenty in 1966, and thirty in 1967.

However, as the applications began flowing in, a severe regulatory bottleneck developed. The time elapsing between a new plant application and commercial operation rose from 86 months in 1966 to 122 months in 1970. These delays were especially costly because capital represents such a large proportion of the total costs of nuclear power. "A plant ordered in 1965 at an estimated cost of $120/kW cost $240/kW on completion," writes Weingast. The ratio of actual cost to initial estimates reached three-to-one by 1968 and kept rising. By 1974, nuclear power had virtually been priced out of the market: new orders slowed to a trickle, and many previously announced orders were cancelled.

Why the bottlenecks? One possible reason is intervention in the licensing process by environmentalists and by municipalities seeking an assured share of power output. But this cannot fully explain the bottlenecks. As Weingast points out, the time lag for *uncontested* construction permits was increasing at least as fast as the lag for *contested* ones. Average delays for uncontested permits rose from nine months in 1966 to twenty-eight in 1970; for contested permits, from fourteen months in 1966 to forty-one in 1970.

Nor were these delays caused simply by inadequate agency resources for reviewing applications. Although the figures were not broken down by function until 1972, figures after that date show that while the AEC/NRC backlog of cases expanded, funding for the licensing process was expanding even faster. Congress, in fact, allocated more money to licensing during this period than the agency requested, apparently in an effort to expedite the licensing process.

The bottleneck grew serious at a time when Congress and the courts were expanding the AEC/NRC requirements—as was the agency itself. The agency added 25 new safety



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standards in 1972, 90 in 1973, 143 in 1974, and 167 in 1975. In addition, a whole new set of issues having nothing to do with safety—issues like automatic antitrust review and "need-for-power"—began to complicate the licensing process.

All in all, Weingast concludes, environmental and other nonproducer groups were highly successful in influencing agency behavior in the late 1960s and 1970s. Moreover, the evidence suggests that while Congress was slightly more sympathetic to producers, it too was substantially influenced by environmental concerns. If the nuclear case is at all typical, U.S. regulatory bodies are susceptible to influence by many types of politically active interest groups, not just producers.

## Speeding Up New Drug Approval at the FDA

*FDA Drug Approval—A Lengthy Process That Delays the Availability of Important New Drugs*, a report to the Subcommittee on Science, Research, and Technology, House Committee on Science and Technology, by the Comptroller General of the United States, May 28, 1980, 83 pp.

Responding to a congressional request, the General Accounting Office undertook to review the Food and Drug Administration's drug approval process. In the course of its investigation, the GAO interviewed U.S. officials and experts in industry, academia, and the FDA (and their counterparts in nine foreign countries). This report by the comptroller general contains the GAO's conclusions and recommendations.

The Federal Food, Drug, and Cosmetic Act requires the FDA either to approve new drug applications within 180 days or grant the applicant a hearing on the deficiencies found. If more time is needed, the agency and the applicant must agree to an extension. However, when the GAO studied 132 new drug applications made in 1975, it discovered that the FDA had approved only 69 (52 percent) by the end of May 1979 and had taken longer than six months to notify the applicant of deficiencies in 86 cases (65 percent). On average, it took the agency twenty months to act, and only one application was approved within the six-month statutory limit.

Among the drugs selected for study were fourteen considered by the FDA to be "important"—providing major or modest therapeutic gains over drugs already being marketed. A number of important drugs were available in other countries before they were in the United States, and, except for Sweden, other countries generally had shorter approval times. Although some of the fourteen drugs studied were available here before being available in some other countries, only one was available here first.

The GAO found six major factors that contribute to these delays in drug approval: (1) FDA guidelines that are imprecise and subject to different interpretation; (2) disagreements between the FDA and the industry involving both scientific and professional questions; (3) the agency's slowness in notifying drug firms of deficiencies in their applications and test procedures; (4) lengthy reviews of drug chemistry and manufacturing controls; (5) insufficient time spent reviewing applications and poor work-load management; and (6) incomplete new drug applications. These problems, the fact that Congress and consumer groups intensely scrutinize what has become an adversary process, and the FDA's essentially conservative approach all contribute to what the GAO concludes are excessive delays in drug approval.

The FDA has already established goals to decrease its processing time by 25 percent for important new drugs and by 15 percent for all others. But, the comptroller general notes, even if these goals are met, approvals will still take, on average, fifteen to seventeen months. Thus, in the interest of reinforcing the FDA's efforts, the report recommends that the secretary of the Department of Health and Human Services direct the FDA commissioner to take the following steps:

- Monitor the FDA's progress toward reducing processing times for new drug applications by 25 and 15 percent over a three-year period and revise actions as necessary to ensure that these goals are met;
- Give drug firms timely notice of deficiencies in new drug applications and of instances when their actions are responsible for delaying drug approvals;
- Expedite development of an improved post-marketing surveillance program and en-



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sure dissemination of program results to reporting physicians; and

- Formally clarify the FDA's policy on the acceptance of foreign data.

The GAO also endorsed the proposed Drug Regulation Reform Act of 1979 (H.R. 4258 and S. 1075), which would require post-marketing surveillance by drug firms and informal procedures for resolving scientific disputes between drug companies and the FDA. This proposal would also reduce regulation in the early phases of new drug testing in an attempt to encourage more drug innovation in the United States. Moreover, in an attempt to get vital drugs into use sooner, the proposal would accelerate approval of "break-through drugs" and allow the restricted distribution of major new drugs before they would be generally available. On the whole, the GAO does not quarrel with the FDA's bias toward safety, but thinks its own recommendations could reduce unnecessary delays in bringing beneficial drugs to the U.S. public.

## The Cost of Regulating Copper Production

"The Economic Impacts of Environmental Regulations on the U.S. Copper Industry" by Raymond S. Hartman, Kirkor Bozdogan, and Ravindra M. Nadkarni, in *The Bell Journal of Economics*, vol. 10, no. 2 (Autumn 1979), pp. 589-618.

This report on the impact of pollution abatement regulation on the copper industry focuses on the Clean Air Act Amendments of 1970 and 1977 and the Federal Water Pollution Control Act Amendments of 1972. It estimates the effects these regulations would have, if they were more vigorously enforced, on costs, prices, production, imports, capacity and its utilization, employment, and domestic consumption.

The authors—Raymond S. Hartman of Boston University and the Massachusetts Institute of Technology, and Kirkor Bozdogan and Ravindra M. Nadkarni of Arthur D. Little Inc. —compare two alternative scenarios developed by the Environmental Protection Agency with a "baseline" scenario to estimate these effects. The "baseline" scenario assumes the existence of the national ambient air quality standards, but without additional rules specifying how those standards are to be achieved. There would be nominal industry compliance through the use of minimal permanent control systems, such as tall smokestacks and production curtailments. The two EPA scenarios assume more stringent restriction on smelter-refinery capacity. The "constrained capacity" scenario posits that new source performance standards are applied to new and replacement capacity and that variances are granted to "dirty" smelters that cannot install reasonably available control technologies. The "reduced capacity" scenario posits that new source performance standards are applied to existing as well as new and replacement capacity (that is, are not granted for "dirty" smelters), which would mean that four existing smelters would close over the forecast period.

The econometric model used by the authors takes explicit account of the oligopolistic decision making of the major group of the primary producers that existed for much of the post-war period through 1974. The model also explicitly incorporates the effects of pollution controls on copper production costs (capital and operating) and the capacity expansion and replacement decisions of the primary producers during all four stages of primary copper production: mining, milling, smelting, and refining.

The authors estimate the effects of the two pollution abatement scenarios relative to baseline conditions, finding these effects to be significant. Should capacity be effectively restricted by EPA regulations, domestic prices would rise considerably in the face of growing demand. By 1987, prices would be 29.4 percent higher under the constrained capacity scenario than under the baseline scenario. Using the reduced capacity scenario, prices would be 38.7 percent higher. The authors also find that, with both alternative scenarios, the production, consumption, employment, and smelter/refinery capacity of the U.S. copper industry would all be substantially lower. However, imports, secondary copper prices, and production costs would all be higher. With the costs of following EPA's technology-based approach so high, the authors recommend effluent fees as a more efficient, lower-cost approach for achieving society's goals.



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*(Continued from page 3)*
profitable, not necessarily in ways that are conducive to other constructions of "welfare." Perhaps each individual is the best court of appeal for the definition of welfare, but only if that individual is exposed to arguments from all sides. Business establishes its own criteria for welfare, which it then satisfies when these criteria become translated into consumer demand. This may be good business, but is it also any part of corporate responsibility, defined in moral, not mercenary, terms?

*Robert L. Heilbroner,*
*New School of Social Research*

TO THE EDITOR:

The trouble with the current debate on "corporate democracy"—aside from the misleading label—is that the adherents of positions on both extremes have fallen into fundamental errors. The conservatives are fundamentally wrong about the condition of the patient, and the activists are hopelessly mistaken about the appropriate therapy.

Ralph Winter, Murray Weidenbaum, and other conservative analysts jump from the obvious truth that economic activity is the *primary* purpose of the business corporation to the obvious error that economic products are its sole output and economic performance the sole criterion for appraising its social impact. Weidenbaum's fable of "SR Inc. and PM Inc." criticizes advocates of greater corporate social responsibility for ignoring the basic role of the corporation. But this criticism is misplaced. All serious analysts (a group in which I include myself) assume that the firm cannot stay in business unless it is engaged in viable economic endeavors and that there may be significant trade-offs between economic and other social performance dimensions (environmental impact, for example). Weidenbaum and Winter, however, insist on an all-or-nothing approach, closing their eyes to the multi-dimensional social impacts of the large business firm and thus denying themselves the broad perspective necessary for serious appraisal of its social purposes and roles.

On the other hand, Mark Green and other supporters of "corporate democracy" proposals apparently believe that more explicit regulation and additional public reporting requirements will produce socially desirable changes in corporate decision processes and business behavior. Unfortunately, long experience suggests that increasingly detailed regulatory burdens will only prove to be counterproductive. Indeed, if more rigorous public control is desired, outright public ownership might be preferable to any substantial increase in external regulation of internal corporate operations. Public ownership might reduce personnel requirements (no need for both a corporate employee *and* a government overseer in every job), and the loss of a managerial responsibility would at least be clarified rather than increasingly confused. The near-universal distaste for increased public ownership should suggest an appropriate wariness with respect to its regulatory prototypes as well.

It seems to me that most of the contributors to the corporate democracy debate share an underlying basic objective—improving the ability of the private market economy to meet the needs of the society that is both its host and clientele. This objective is also widely acknowledged within the corporate community, and substantial efforts to broaden the base of corporate decision making to include multiple social considerations (always, of course, within a context of economic efficiency) are already under way. This process should be strongly encouraged by outside analysts of all persuasions. Green and his colleagues should stop trying to persuade Congress to force firms into new formalities of dubious merit, and should start trying to show how any one of their proposed reforms might actually work in practice and what its potential effects might be on the various constituencies of the firm. Weidenbaum should show us how a merged "PM & SR Inc." could analyze and balance multiple objectives in pursuit of long-term economic and social viability. And Winter should recognize that the large business firm is a complex social and political institution and use that recognition to "address real problems sensibly."

*Lee E. Preston,*
*Center for Business and Public Policy,*
*University of Maryland*

MURRAY WEIDENBAUM responds:

I plead guilty to Robert Heilbroner's contention that an obligation to satisfy the need of consumers is like an obligation to do oneself a favor. Of course, Adam Smith said it much better when he counseled, in his famous statement, that we should depend for our dinner not on the benevolence of the butcher, the brewer, or the baker, but on their regard for their own interest.

Lee Preston's criticism is more disconcerting. I cannot find any basis for his contention that I close my eyes to the social impact of the business firm and view its economic performance as the sole criterion for appraising its social impacts. Fundamentally, my article is a plea for altering the balance between economic and social factors that is usually found in the literature on social responsibility. As I wrote, "Surely, the social impacts of business merit attention. . . . The contributions of business to meeting other [noneconomic] concerns of society are surely not trivial." Perhaps Professor Preston will be reassured when he recalls this statement: "My concern is not with the notion of paying some attention to the social dimensions of the business firm but with our growing habit of treating these noneconomic factors as paramount, sometimes I suspect unwittingly." In any event, I hope our readers are reassured.

## The Regulatory Budget

TO THE EDITOR:

Christopher DeMuth's two-part article on "Constraining Regulatory Costs" (January/February and March/April) was exceptionally thoughtful and stimulating, but strikingly inconclusive about the direction regulatory policy should take. This omission is understandable. Designing procedures that will help officials act wisely in making *political* decisions is inherently difficult and often reduces even keen, sophisticated critics to wishful naivete.

DeMuth's statement of the problem is, I think, roughly right. Administration proposals to bolster regulatory analyses—requiring agencies to count costs, predict effects, and explore alternatives—cannot, by themselves, force regulators to *decide* differently. Only the threat of presidential (or judicial or congressional) intervention against undesirable regulations can do that. Yet presidents have solid reasons for not intervening. Jumping into the middle of a regulatory dispute is seldom wise. The concept of a regulatory budget is attractive pre-



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cisely because it forces the president and Congress to set regulatory cost totals and allocate allowable costs among agencies, and then allows them to step aside, leaving the development of specific regulations to the agencies.

While a regulatory budget would provide agencies with an incentive to reduce regulatory costs, it would also generate perverse incentives. For example, counting only actual expenditures as costs could induce the Environmental Protection Agency to seek cleaner air by forbidding new pollution sources rather than by requiring pollution controls. The bias toward new-source controls could mean, ironically, that a regulatory budget could actually foster an extension of government controls.

While DeMuth is worried about such potentially perverse effects, I believe he underestimates them. In order to be able to assess the scheme more fully, we need several careful studies on how agencies might behave under a regulatory budget with a sample of regulatory issues. I do not think our current situation is so desperate that we should plunge into a regulatory budget before we have such studies.

I also think that DeMuth underestimates the efficacy of the current regulatory review program and the potentially favorable effects of expanding that review capability. In discussing OSHA's cotton dust standard, for example, he argues that pressure from CWPS played no role in OSHA's decision to substitute a more cost-effective standard for its original uniform rule. But, in fact, OSHA was under serious attack at the time by several top administration officials for not following the more cost-effective approaches that CWPS had been recommending. Without the CWPS analyses and the top-level pressure, I doubt OSHA would have changed its original proposal. Surely a major increase in the number of regulatory analysts could be justified in the light of the important role regulation has come to play.

As for White House review, I cannot envision any formal mechanism that would satisfactorily resolve the conflict between developing an intervention technique that is tough enough to restrain agency discretion in writing regulations but still allows needed flexibility. However, I think that small, useful improvements could emerge from strengthening regulatory oversight in the executive branch. (And this, incidentally, is the most likely place for such improvement. Quite aside from doubts about the competence and appropriateness of judicial oversight, the Supreme Court's recent decision on OSHA's benzene standard suggests that the courts are not going to create any consistent guidelines for regulation. And, while Congress will continue to exercise some oversight, time constraints on its members make it a poor forum for a larger regulatory review role.)

One small, but useful step for giving the White House influence over "the broad picture," while keeping it out of the day-to-day struggle over particulars, would be an annual presidential address to Congress. Such an address would discuss the major regulatory proposals contemplated for the coming year, review the major regulatory initiatives undertaken in the past year, and present rough estimates of total regulatory costs by agency. This is not to suggest that the address would constitute the president's regulatory program in the same sense that his proposed fiscal budget sets spending priorities. Presidential approval would not be a prerequisite for promulgating regulations. There is, of course, both a danger and a hope in the likelihood that inclusion of a proposal in the address would be tantamount to the president's endorsement. The danger is that this could block later attempts at review; the hope is that the president would obtain sharper analysis before including a proposal in this message.

The presidential message would not have to quantify all regulatory costs and impacts. Some flexibility is needed for what remains largely an educational process (not least of all for the White House). Both my proposal and a regulatory budget would be subject to problems of timing, but these do not seem insurmountable. A greater qualm is whether the additional work to generate the information needed to make regulatory decisions is really worthwhile, especially if the information is not going to be used in the context of a regulatory budget. I think the answer is yes, especially since the Regulatory Council's calendar already provides a piece of the infrastructure. Nothing as elaborate or detailed as a Regulatory Cost Accounting Act is required at this time; more analysis, not more information, is currently our most glaring need.

*John Mendeloff,*
*University of California,*
*San Diego*

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## William J. Baroody, Sr.
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William J. Baroody, Sr.
Final public address
Albion College Commencement
May 10, 1980

In appreciation of his many contributions
The Editors

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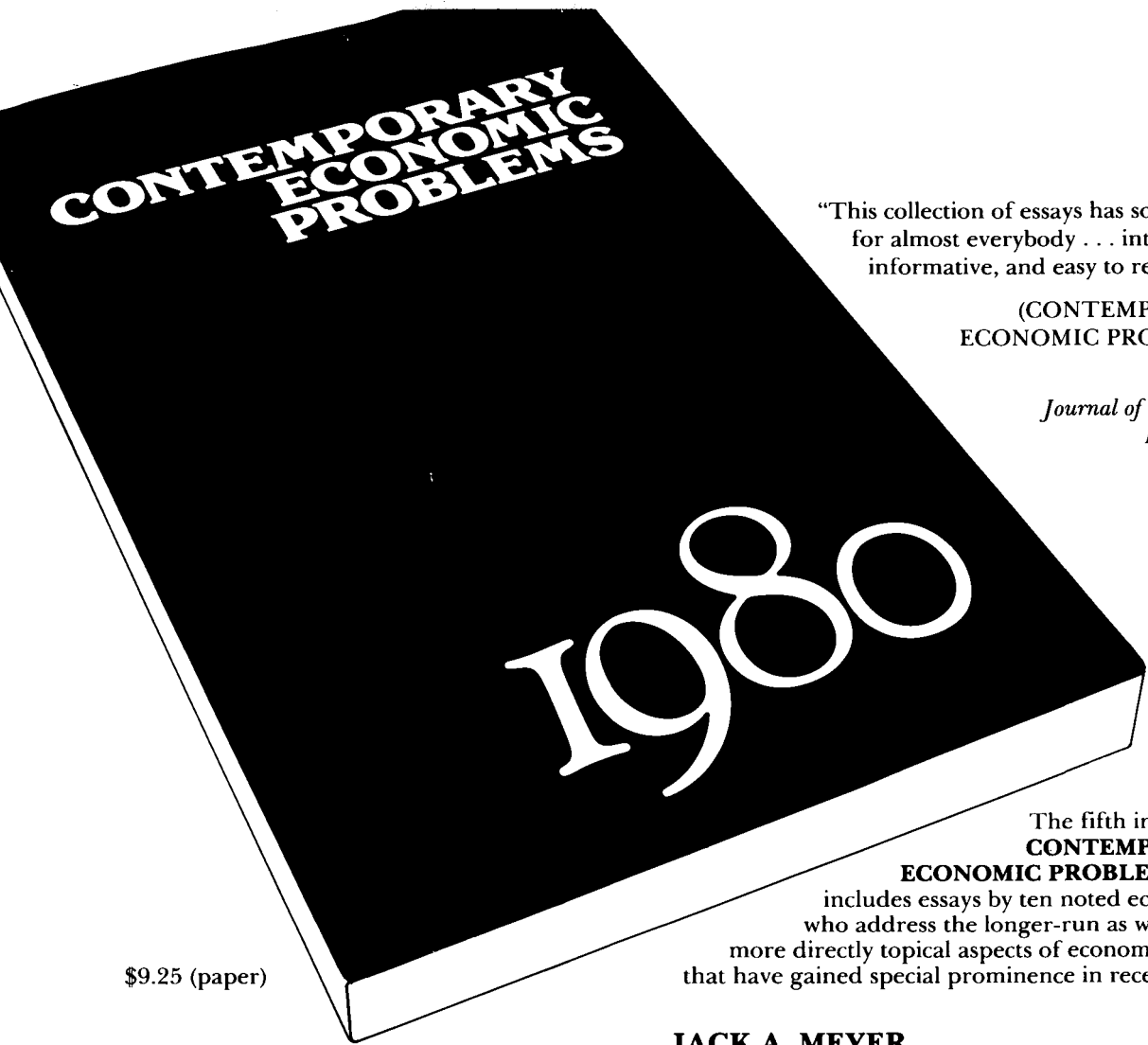


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